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THE POLITICS OF TRADE IN THE SOUTHERN AFRICAN CUSTOMS UNION (SACU): PROSPECT OF A SACU-CHINA FREE TRADE AGREEMENT

by

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DECLARATION

I hereby certify that, unless specifically stated to the contrary in the text, this dissertation is the result of my own original work.

CARINE ZAMAY KIALA

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LIST OF ABBREVIATIONS AND ACRONYMS

ACP	-	African, Caribbean and Pacific countries
AD	-	Anno Domini
AIDS	-	Acquired Immune Deficiency Syndrome
AfDB	-	African Development Bank
AGOA	-	African Growth and Opportunity Act
ANC	-	African National Congress
AU	-	African Union
BC	-	Before Christ
BLNS	-	Botswana, Lesotho, Namibia and Swaziland
BLS	-	Botswana, Lesotho and Swaziland
CCP	-	Chinese Communist Party
CCS	-	Centre for Chinese Studies
CGE	-	Computable General Equilibrium
CMA	-	Common Monetary Area
CNM	-	Common Negotiating Mechanism
COMESA	-	Common of East and Southern Africa
CRP	-	Common Revenue Pool
DDA	-	Doha Development Agenda
DFA	-	Department of Foreign Affairs
DTI	-	Department of Trade and Industry
EDF	-	European Development Fund
EPA	-	Economic Partnership Agreement
EU	-	European Union
FDI	-	Foreign direct investment
FMCG	-	Fast Moving Consumer Goods
FOCAC	-	Forum on China-Africa Cooperation
FTA	-	Free trade area / agreement
G7	-	Group of Seven
G20	-	Group of Twenty
GATT	-	General Agreement on Tariffs and Trade
GATS	-	General Agreement on Trade Services
GDP	-	Gross domestic product
GEAR	-	Growth, Employment, and Redistribution
GEDA	-	Gauteng Economic Development Agency
GTAP	-	Global Trade Analysis Project
HDI	-	Human Development Index
HIV	-	Human Immunodeficiency Virus
HTCs	-	High Commission Territories

ICT	-	Information and Communications Technology
IFI	-	International Financial Institutions
IGD	-	Institute for Global Dialogue
IPE	-	International Political Economy
IPRs	-	Intellectual Property Rights
ITO	-	International Trade Organisation
LDCs	-	Least Developed Countries
LSE	-	London School of Economics
MERCOSUR	-	Mercado Común del Sur
MFN	-	Most-Favoured Nation
MMA	-	Multilateral Monetary Agreement
MNC	-	Multi-National Corporation
MOU	-	Memorandum of Understanding
NAFTA	-	North American Free Trade Agreement
NEPAD	-	New Partnership for Africa's Development
OECD	-	Organisation for Economic Cooperation and Development
PAC	-	Pan Africanist Congress
PRI	-	Partido Revolucionario Institucional
PRC	-	People's Republic of China
PTA	-	Preferential Trade Agreement
RIA	-	Regional Integration Arrangement
RDP	-	Reconstruction and Development Programme
RMA	-	Rand Monetary Area
ROC	-	Republic of China
ROW	-	Rest of the world
SA	-	South Africa
Sacob	-	South African Chamber of Business
SACU	-	Southern African Customs Union
SAIIA	-	South African Institute for International Relations
SADC	-	Southern African Development Community
SADCC	-	Southern African Development Coordination Conference
SAPs	-	Structural adjustment programmes
SARB	-	South African Reserve Bank
SEFTA	-	South Africa-European Union Free Trade Area
SDT	-	Special and differential treatment
SMMEs	-	Small, micro and medium enterprises
SOE	-	State owned enterprise
SWOT	-	Strengths, Weaknesses, Opportunities, and Threats
TCF	-	Textiles, Clothing and Footwear
TDCA	-	Trade, Development and Cooperation Agreement
TMA	-	Trilateral Monetary Agreement
Tralac	-	Trade Law Centre of Southern Africa

TRIMs	-	Trade-Related Investment Measures
TRIPs	-	Trade-Related Aspects of Intellectual Property Rights
UN	-	United Nations
UNCTAD	-	United Nations Conference on Trade and Development
UNDP	-	United Nations Development Programme
US	-	United States
USA	-	United States of America
USSR	-	Union of Soviet Socialist Republics
WTO	-	World Trade Organisation
ZAR	-	South African Rand

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MAP OF SACU IN AFRICA

Legend

B	Botswana
L	Lesotho
N	Namibia
S	Swaziland
SA	South Africa

ABSTRACT

Considering the obstacles to the conclusion of the Doha Round of international trade negotiations, bilateral free trade agreements (FTAs) are the new trend emerging in international relations. Hence, the Southern African Customs Union (SACU) and China intend to negotiate such an agreement in order to promote trade and investment between their markets.

However, SACU is an organisation with a colonial legacy that continues to debilitate the economies of its weaker member states. Discrepancies in its administration and operation threaten the integrity of the customs union, especially when third parties are involved.

This study assesses the politics of trade in the Southern African Customs Union, and the prospect of a FTA with the People's Republic of China. It explores the quantity and quality of trade between the parties, as well as the role of the state in encouraging economic diplomacy. The dissertation draws on the experiences of other developing countries that have signed FTAs with stronger economies, in order to provide policy recommendations that will steer sustainable trade relations between SACU and China that will be aligned to SACU's development agenda.

The study concludes that a FTA will stimulate a restructuring of SACU's trade partners, without creating a significant increase in production or employment. Furthermore, the cost competitiveness of Chinese imports will cripple the respective SACU industries, cause unemployment and negate prospects of new industrialisation in certain sectors of the economy. SACU's strategy for trade liberalisation should be incremental and sector specific.

OPSOMMING

‘n Nuwe tendens wat toenemend voorkom in internasionale verhoudinge, veral na aanlieding van die problematiese aard van die Doha-rondte onderhandelinge, is bilaterale vrye handelsooreenkomste. Dit is dus nie verbasend nie dat die Suider-Afrikaanse Doeane-Unie (SADU) en China die onderhandeling van ‘n bilaterale vrye handelsooreenkoms in die vooruitsig stel nie.

SADU is egter ‘n organisasie met ‘n koloniale erfenis wat steeds die ekonomieë van ekonomies swakker en onderontwikkelde lidstate inhibeer. Probleme in terme van die werking en administrasie van SADU skep ‘n bedreiging vir die integriteit van die doeane-unie, veral in gevalle van derde-party betrokkenheid.

Hierdie studie evalueer die handelspolitiek in SADU en ondersoek die vooruitsig van ‘n vrye handelsooreenkoms met die Volksrepubliek van China. Die studie ondersoek die hoeveelheid en aard van handel tussen die partye, asook die rol van die staat in die bevordering van ekonomiese diplomasie. Die verhandeling maak gebruik van die ervaring van ander ontwikkelende state wat sodanige ooreenkomste met sterk en ontwikkelde state gesluit het ten einde uit hierdie ervarings ‘n aantal beleidsvoorstelle te formuleer wat die verhoudinge tussen SADU en China kan lei op grond van SADU se ontwikkelingsagenda.

Die studie kom tot die gevolgtrekking dat ‘n vrye handelsooreenkoms ‘n verandering van SADU se handelsvennote tot gevolg sal hê, maar nie ‘n merkbare toename in produksie en werkskepping sal veroorsaak nie. Ook sal die koste-kompeteerbaarheid van Chinese invoere groot nadeel inhou vir SADU industrieë, werkloosheid bevorder en in sommige sektore van die SADU ekonomieë nuwe industrialisering in die wiele ry. SADU se strategie vir handelsliberalisering behoort inkrementeel en sektor-spesifiek te wees.

CHAPTER 1

INTRODUCTION AND BACKGROUND

1.1 Introduction

In June 2004 the Second Meeting of the South Africa - People's Republic of China Bi-National Commission was held in Pretoria. Zeng Qinghong, Vice President of the People's Republic of China (PRC), co-chaired the meeting with Jacob Zuma – then Deputy President of South Africa (SA). Towards the end of July 2004, the two countries released a joint communiqué citing their recent diplomatic engagements, which articulated their intention to negotiate a free trade agreement (FTA) between the Southern African Customs Union (SACU) and the PRC (DFA 2004: Internet). The FTA has become a popular mechanism of conducting bilateral trade relations. The rationale is to fast-track trade liberalisation between consenting parties. Although the role of the state is limited during the actual exchange of goods and services, unless involving parastatals, the FTA certainly sets a precedent to encouraging trade in the private sector. However, the mere ratification of a trade agreement at a political level does not necessarily lead to increased trade between parties. Quite the opposite; it is a trade profile – determined by magnitude and variety – that is indicative of a need for preferential terms of trade. As such, the signing of a free trade agreement has ambiguous connotations, because it blurs the distinction between the role of the state and that of the market.

From the realist perspective of the international system, power and industries are used to secure the state through an approach of Economic Nationalism. Trade is instrumental in this regard, as it provides of mean of generating wealth and influence. Therefore, behind the facade of political rhetoric and ceremonial expressions of diplomatic solidarity, trade is a critical tool used strategically to further one's national interests. Multilateral institutions have thus been established to facilitate and regulate the terms of trade. Furthermore, each institution has its own agenda, as does each state. Nevertheless, in the contemporary international system there is a general consensus for the support of trade liberalisation. This is evident from the membership of the World Trade Organisation (WTO), primarily, and the endorsement of its current mandate. The role of the WTO is to manage the elimination of trade barriers between all its members. Although the SACU countries – Botswana, Lesotho, Namibia, South Africa and Swaziland - and the PRC are all members of the WTO, it appears they would prefer to negotiate an exclusive preferential trade agreement (PTA) in the interim – even if it were to ever become redundant under the WTO. This decision may be justified by the WTO's inability to resolve world trade issues, hence the collapse of the Doha Round in mid 2006. Although the trade negotiations resumed in early 2007, countries may be losing confidence in its effectiveness (see Chapter 2).

Nonetheless, world trade subsists through dialectic forms of cooperative competition – cooperation is a rational necessity in a global community, but the inherit competition implies there is a cost. Therefore, perhaps global attempts at trade liberalisation should be viewed cautiously. Since the WTO evidently has its weaknesses, more countries are opting for bilateral means of improving trade. Observe the number of PTAs being signed between strategic trade partners. Europe, for instance, launched 'Europe 92'. It strengthened regional integration from Lisbon to Copenhagen into one single market by removing trade barriers from capital, goods and services. By merging the strengths of individual countries, the confederation became more competitive in the global market. In response, the United States of America (USA), Canada and Mexico established the North American Free Trade Agreement (NAFTA) (Martin & Schuman 1996: 113). Externally, their motive was to restore a balance in world trade and make them more globally competitive. However, their internal motive was typical of most PTAs – they each chose to strengthen their trade ties with their most dominant trade partners. In addition, note that NAFTA marked the first instance in which a developing country was integrated into such a trade bloc with developed countries.

In Africa, SACU[1] is the only fully operational regional FTA bloc. Although its members are part of international trade organisations, as well as other regional trade organisations, their legal obligation to SACU is foremost because of its superior level of integration and incorporation into their domestic laws. The question of overlapping membership in

1 In this dissertation SACU is also referred to as "the region".

Southern Africa has raised much debate in political discourse. The SACU members' dual membership of regional organisations may potentially cause conflict during the execution of FTAs in the Southern African Development Community (SADC) and in the Common Market of East and Southern Africa (COMESA). Already, South Africa's unilateral signing of the Trade, Development and Cooperation Agreement (TDCA) with the European Union (EU) in May 2004 brought tension to the SACU region. It has incited significant debate over the implications of the FTA for South Africa's industrialisation, the economies of the remaining countries and the region's integration. Following the TDCA, the EU proposed Economic Partnership Agreements (EPAs) with the remaining SACU countries – Botswana, Lesotho, Namibia and Swaziland (BLNS), as well as the other signatories of the Cotonou Agreement[2]. However, this duality has compromised the region's solidarity across geo-political spheres and its efforts for an integrated regional development programme (see Chapter 4). Accordingly, the prospects of a SACU-China FTA stir similar concerns.

The FTA concept stems from liberal trade theory. It promotes an open market system that reduces and/or eliminates tariffs and quotas. O'Brien and Williams (2004: 139) argue that liberal theory is counter-intuitive. It offers a positive-sum perspective on trade, which critics contend as being zero-sum. Therefore, can trade truly be mutually beneficial? This question constitutes one of the greatest debates in the international trade system. It is also the basis upon which structuralist theories refute the global market, pin-pointing supposed North-South divisions between the centre and the periphery (Galtung 1971: 86). Radical theories propose that developing countries delink from the global system. By adopting protectionist policies, their domestic industries will operate in a sheltered environment where they may flourish without the interference of competition. However, perhaps there is middle ground between both extremes.

The possibility of an FTA between SACU and China epitomises the above-mentioned debates, and exposes tensions in the international trade system. SACU's balance of trade with the PRC is heavily skewed in China's favour, most of which is channelled through South Africa. On its own, SA's balance of trade deficit with China rose by 70 percent -

[2] The Cotonou Agreement is a treaty between the European Union and the group of African, Caribbean and Pacific states (ACP countries). It was signed in 2000, and currently has a membership of 48 sub-Sahara African countries (ACP 2008: Internet).

from ZAR 22.7 billion in 2005 to ZAR 32 billion in 2007 (DTI 2006, 2008: Internet). The magnitude of trade with China brings competition for the region's manufacturing sector and thereby reduces the prospects of developing commercial industries in the region. Considering the profile of trade products between both parties, diversifying SACU's current commodity-driven export profile is a great challenge. Typically, manufactured goods would need to become the vehicle of SACU's export capacity. This is an optimal choice for sustainable development in the region, but would it meet the Chinese market's demand? It is thus important to question China's position in this instance, how China would fit into SACU's economic agenda and whether an FTA would compliment SACU's needs.

Trade liberalisation entails the removal of barriers from economic activities to foster greater openness and integration of countries. However, as early as between 1973 – 1979, several issues were already raised about trade liberalisation during the Tokyo Round of negotiations of the General Agreement on Tariffs and Trade (GATT). One of the key issues, a matter that is fundamental in this dissertation, was how states could possibly deepen trade relations whilst accommodating economies that were at differing stages of development (Woolcock 1999: 31). Consumers acknowledge the benefits of trade, especially in marking down prices, but there are a number of implications to consider about market liberalisation. Certain Chinese products that are sold in SACU, for instance, are much cheaper than the locally produced alternatives. This may induce local manufacturers to be more efficient and even lower the retail cost of their products. However, once local manufacturers can no longer compete, as their production costs exceed their profit margins, their operations will seize. Therefore, giving preference to imported products (due to the lack of local production or cost competitiveness) can cause tension between parties by placing inevitable strain on domestic industries and the labour force. The act omits a level of dependence from the importing party and consequently surrenders power to the exporting country.

A SACU-China FTA would need to accommodate the differences in the economies of China and the SACU countries. The TDCA, for instance, makes specific provisions for the differing levels of economic development between the EU and SA. It provides protection for sensitive product sectors, and even extends safeguard conditions for products that are of interest to the BLNS states (Venter & Neuland 2004: 207).

Therefore, as initially instituted in GATT's (now the WTO) Most-Favoured Nation code and in the TDCA mentioned above, SACU may also need to consider retaining a certain level of protection in its FTA negotiations with China.

Would the purpose of a SACU-China FTA be to widen the trade relations between the two partners or to deepen their profile/portfolio of trade? Woolcock (1999: 25) wrote that to widen trade relations entails increasing the number of countries that adhere to a liberal international trade paradigm. However, to deepen trade relations is to integrate and consolidate domestic policies. This may be considered intrusive, as it is difficult to capture an agreeable system of rules. Import liberalisation, for instance, can benefit the economy of one party but may also harm the domestic industries of another party to the agreement. In September 2006, the South African Government installed restrictions on the import of garments made in China, precisely to protect its domestic textile and garment industry. This stance indicates that the region does need to take precautionary measures towards trade liberalisation with China.

FTAs may hold severe consequences for member countries, especially regarding political stability. Another detriment is the perception that the state needs to provide and protect employment opportunities, so as to appease its electorate. Although it may appeal to SACU to import goods from China that would be affordable for end-consumers, this would heavily impact the region's own initiatives to establish similar industries. As such, note that an FTA may result in the loss of existing industries and jobs, as well as potentially forfeit new industries and their employment opportunities.

This dissertation proposes to examine the politics of trade between SACU and China, if the possibility of an FTA were to be realised. The study aims to make the following contributions: First, the study will provide a critical evaluation of the current trade relations between SACU and China by examining the trend in the volume of trade products relative to products manufactured in SACU. Second, it will expose the limitations of an open market system and the need for sector specific protectionist frameworks to sustain SACU industries. In order to substantiate this analysis, attention will be paid to the effect of NAFTA on Mexico and the protectionist measures taken in the TDCA between the EU and South Africa. Third, it will provide policy recommendations for SACU's engagement with China, to ensure that its trade relations are not based on or determined by dependence, but rather by a partnership that is indeed mutually beneficial and also reflective of SACU's development agenda.

1.2 Literature Review

The literature investigating trade between SACU and China is varied. However, its focus is generally reactive, observing how existing trade has had an impact on the region. Even so, the literature review conducted in this study reveals that the scholarly works on the impact of trade with China as well as the feasibility of a SACU-China FTA have predominantly focused on South Africa, and less on the BLNS countries. In order to corroborate the possible futures envisaged for SACU, the literature review of the dissertation will discuss the following:

- The two contending paradigms in international trade theory;
- The normative literature that evaluates the relevance of FTAs, with a discussion of NAFTA and the EU-SA TDCA;
- The empirical literature on China's relations with Africa, focusing specifically on its relations with SACU.

There are two main contending paradigms in international trade theory: protectionism and Liberalism (see Chapter 2). The protectionist theories of zero-sum game argue that trade benefits only one party. Free trade between countries thus compromises the economy of the lesser-developed partner, exposing its infant industries to foreign dominion. For this reason, protectionist measures are implemented to sustain domestic industries (O'Brien & Williams 2004:138). International trade theory, the concept of free trade, and the institutionalisation thereof are dissected using literature from the following sources: Balaam & Veseth (1996), Stubbs & Underhill (1994), Gilpin (2001), Grieco & Ikenberry (2003), Heller (1968), Hocking & McGuire (1999), Strange (1988), O'Brien & Williams, and Salvatore (1987) amongst others. However, these studies remain general, even in their critique of trade between developed and developing states.

In practice, the developed states also employ protectionism against developing and underdeveloped trade partners. So, for instance, agricultural exports to the EU are subject to tariffs and quotas. The farmers in the EU receive state subsidies, which make their products more prone to depreciation[3] and dumping in foreign markets. This reaction to free trade implies that both parties are casualties of trade. Therefore, the distinction between trade winners and losers is not always clear. Gilpin (2001: 200) argues that representatives of the less developed country view free trade as a form of imperialism, which increases one's dependence on the developed country. Likewise, the more developed country views free trade as a threat to jobs and domestic social welfare, hence the EU's reluctance to terminate farmer subsidies. Jensen and Sandrey (2006: 10) envision that SACU and China may adopt a similar disposition to free trade, by installing protectionist policies on their respective sensitive sectors. In this case, perhaps only a pragmatic cut in bilateral tariff rates would be feasible, instead of a complete removal of trade barriers.

Liberal trade theory rebuts protectionism and advocates for the contrary. It argues that protectionist measures breed monopolies and decrease competition, whereas free trade increases efficiency and raises production. The liberal commitment to free trade is individualist; it intends to benefit the consumer by reducing prices, maximising consumer choice and facilitating the efficient use of the world's resources. Using this logic, the main reason for exporting goods is therefore to finance one's imports, and not to empower the state (Gilpin 2001: 198). In NAFTA's case, free trade has certainly raised production rates in Mexico. After Canada and Japan, Mexico was the USA's third largest trading partner in 1993. It consumed 9 percent of its exports, worth US$ 42 billion of which 85 percent was used to purchase manufactured goods. The contestation that Mexico was too poor to sustain its imports from the USA was vindicated by a selection of data. Many of the USA's manufactured exports were intermediate goods that required further processing in Mexico and reshipment back to the USA (Weintraub 1994: 23). In this case, free trade generated a manufacturing industry and export diversification through technology transfer. However, what are the prospects of technology transfer between China and SACU?

At the core of liberal trade theory is David Ricardo's notion of comparative advantage, offering a positive-sum view of trade. Keohane and Nye (1989:24) marked the concept as one of complex interdependence, which better justifies the reasoning for comparative

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[3] Producers depreciate their goods by reducing sale prices, usually below standard market price.

advantage than does Realism (Keohane & Nye 1989: 24). Parties simultaneously gain from free trade by trading their product and/or service of comparative advantage (O'Brien & Williams 2004: 139), providing the other with its deficient products and/or services. As is the case in NAFTA and in the TDCA, the respective parties trade at a comparative advantage. Therefore, instead of free trade being considered a loss for both parties, there is positive-sum gain.

Before examining SACU's bilateral relations with China, it is imperative to study the regional dynamics within SACU. Richard Gibb has written extensively on the subject of regional integration in Southern Africa, and especially on SACU. Of his three publications used in this dissertation (1997, 1998 and 2001), his paper entitled *Regional Integration in Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union* (1997: 67 - 86) is especially noteworthy. The content is insightful regarding the history of SACU's political foundation, the implications thereof on its constitution and the operational challenges that it faces.

China's gross domestic product (GDP) in 2007 was US$ 7.043 trillion; SACU's combined GDP in 2007 was only US$ 510.922 billion (CIA World Factbook 2008: Internet). Of SACU member states, South Africa is China's largest trading partner but its engagement is rather peripheral. The country's main exports to China are aluminium, auto components, chrome ore, copper, iron ore, gold, granite, manganese and tobacco (Naidu 2005: 470). Chinese exports to the region are manufactured goods for direct sales in the market. Reflective examination of the terms of trade exposes discrepancies intrinsic of competitive advantage between the trading parties. China has an extensive cheap labour force that is skilled and also educated. SACU has a weaker industrial foundation based mostly in South Africa, which also has much stringent labour laws than China. Lack of substantial comparative advantage leaves only competitive advantage.

Ricardo's theory of 'comparative cost advantage' is not congruent with SACU's development agenda. It is static, confining and suggests that SACU states perpetually export raw materials to China in exchange for manufactured goods (Salvatore 1987: 268). Dickens (1998: 31) observes that since the 1970s manufactured goods account for an increasing amount of total exports in developing countries, however varied. China's increased manufacturing capacity is illustrated by its remarkable economic growth – which averaged at a double-digit GDP growth rate during the 1980s and at 9.7 percent during the 1990s. The growth rate has since recovered to 11.4 percent in 2007 (CIA World Factbook 2008: Internet; Thurow 2003: 203).

The arguments raised above connote an emerging dependency relationship between the two parties. The bulk of SACU's industrial sector, which is based in South Africa, is concentrated on mining, automobile assembly, metalworking, machinery, iron and steel, chemicals and foodstuff (CIA World Factbook 2008e: Internet). Of China's total imports from South Africa in 2005, 79.4 percent were mineral products and base metals (DTI 2006: Internet). Although China and SACU states are equally considered developing countries, their economies are very different. Without direct value added, SACU's position appears rather peripheral; it seems not to encourage development through industrialisation, but rather limits its development efforts to mere trade.

In recent years, the reporting on African relations with China has grown exponentially. However, theoretically-informed literature on the subject is only published by a few of the most prominent South African-based research institutes and think tanks, e.g. the Centre for Chinese Studies (CCS) at Stellenbosch University, the South African Institute for International Affairs (SAIIA) at Witwatersrand University, the Trade Law Centre for Southern Africa (Tralac), the Institute for Global Dialogue (IGD), and the Institute for Security Studies (ISS). Many of the reports referred to in this dissertation were written or co-written by Dr Ron Sandrey (2006a, 2006b) and Hans Grinsted Jensen (2006, 2007) of Tralac, Dr Martyn Davies (2005, 2006) and Sanusha Naidu (2005) of the CCS, Garth Le Pere (2006, 2007) of the IGD, and Prof Chris Alden (2005, 2006) a research associate at SAIIA and Senior Lecturer in International Relations at the London School of Economics (LSE).

Alden (2005: 138) identifies four factors that shape China's approach to engaging in Africa, namely "resource security, new markets and investment opportunities, symbolic diplomacy and development co-operation, and strategic partnerships." During the early 1990s China shifted from being a petroleum exporting country to now being a net importer of petroleum – consuming approximately 5.46 million barrels a day. For a country that is experiencing such an accelerated rate of industrialisation, it is a national interest to seek preferential terms of trade with strategic trade partners that would increase its access to markets, resources, and technology in order to feed its domestic industries (Grieco & Ikenberry 2003: 126). Therefore, trade liberalisation between SACU and China would provide China with the means of securing its national security. Whether SACU's interest in China offers similar prospects of security or is instead a threat to the region is debatable. A SACU-China FTA would offer SACU countries preferential market access into China for their mineral resources and agricultural products, giving them a competitive advantage over the rest of China's import partners. Simultaneously, China would obtain guaranteed market access for its technological and manufactured goods into the SACU region. Both parties thus recognise their mutual benefit and/or complex interdependence.

Critics of market liberalisation contend that an FTA between partners of unequal economic standing creates an illusion of advantage through complimentary dependence. They argue that the illusion thus enables a subtle detraction of industrialisation from the weaker economy. Ultimately, it may compel each partner to produce and export only according to its comparative advantage, which may not necessarily be optimal (Roberts 2000: 608). SACU's exports to China, for instance, are demonstrative of the region's comparative advantage. Therefore, an FTA may only guarantee a quantitative increase in trade with no assurance of trade diversity.

Literature on China's engagement with SACU predominantly discusses the increasing presence of Chinese firms in the region, much like on the rest of Africa (see Alden & Davies, 2006). Its focus on Chinese politics is limited to providing an alternative development model for Africa, as well as it being an unorthodox source of long-term loans devoid of 'Bretton Woods' conditionalities[4] (see Lyman 2006; and White & Alves 2007). The need exists for literature that critically evaluates the proposition of a SACU–China FTA, assessing the implications of such an arrangement to determine what policies are required to ensure the sustainable development of SACU domestic industries. This study will aim to fill part of this gap by evaluating the prospects of a SACU-China FTA. The present study will describe, analyse and explain the implication for SACU's industrial sector of doing business with China under an FTA.

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4 This premise is developed in Chapter 2 of the study.

1.3 Identification and Demarcation of Research Problem

It is clear from the literature survey that there is a gap in existing knowledge about the impact a possible FTA between SACU and China would have on the manufacturing industries of the SACU states. The purpose of this dissertation therefore is two-fold: to evaluate the extent to which SACU's manufacturing sector can compete with Chinese imports under an FTA; and to assess whether the terms of trade between both parties accommodate SACU's industrialisation.

A central principle of trade theory is the assumption that liberal trade fosters development – namely industrialisation and economic growth. The Western development model dogmatically encourages developing countries to open their markets and privatise national enterprises. Yet, this model, which was also promoted by the international financial institutions' structural adjustment programmes (SAPs), produced contradictory outcomes and further devastated weak economies throughout the African continent (Hermele 2005: Internet). Modern liberal trade theory contains derivatives of the 'comparative advantage' concept. The factor endowment theory, in extension, focuses precisely on using input products that are in abundant supply in order to maximise production (O'Brien & Williams 2004:140). This theory explains China's use of its large population to reduce the cost of labour, and thereby be exceptionally competitive by global standards in its production of goods that are labour-intensive.

Ricardo's theory of 'comparative cost advantage' is arguably invalid under SACU-China trade terms. Capital and private companies are no longer confined to their country of origin; they are increasingly mobile and/or globalised. Relative differences in cost no longer drive business. The definitive factor, according to Martin and Schumann (1996: 111), is an absolute advantage in all markets and countries simultaneously. The emphasis has thus shifted to differences in opportunity costs. Furthermore, unlike in the case of Mexico in NAFTA, SACU does not have the cheaper labour force and is receiving marginal technology transfer.

By assessing the compatibility of a SACU-China FTA with SACU's development agenda, this study aims to evaluate two components of the research problem. First, to what extent can SACU's manufacturing sector compete with cheap Chinese imports?

Second, to what extent would the terms of trade between SACU and China accommodate SACU industrialisation, as opposed to perpetuating the region's marginalisation and under-development?

The explanatory proposition to the first component – cheap Chinese imports will undercut SACU's manufacturing sector – proposes that although cheap imports from China are genuinely more affordable to the end-consumer in SACU, the repercussions could be detrimental. It may cause a decline in SACU's manufacturing production, which may negatively impact the labour force, yet encourage a dependency on Chinese imports. Once a country becomes economically dependent on another, it undermines the political autonomy of the state.

The explanatory proposition to the second component – the balance of trade between SACU and China may project a dependency complex for the region; South Africa has the largest balance of trade with China, of SACU's five members. Even so, South Africa's exports to China are commodity-oriented (Naidu 2005: Internet). Chinese exports to the region are manufactured goods for direct sale in the market. An FTA would endorse China as a de facto manufacturing hub for SACU's input products. This poses an enormous challenge for SACU's development of local industries and employment opportunities, and a threat to technology transfer.

1.4 Methodological Aspects

This dissertation is descriptive-analytical in nature. The qualitative research employs International Political Economy to assess the implications for SACU's manufacturing sector on trading with China under an FTA. It is based on theoretically-informed content and critical analysis.

The dissertation will utilise a holistic body of data sources comprising primary sources, official documentation, policy documents, theoretical literature, as well as critiques and discussion papers from the media.
A range of source material has been used:

- Primary documents: the *SACU* documents (1969 and 2002), which form the basis of the study, as well as the *NAFTA* document and the *EU-SA TDCA* document.

- Theoretical literature and critical scholarship consulted dealt with international political economy, international trade theory, regional integration, the free trade area/agreement, industrialisation and economic development.
- Secondary sources consulted dealt with SACU's integration, South Africa's experience with Chinese trade, the challenges of small land-locked states and the implications of market liberalisation.

1.5 Structure of Research

The study is divided into six chapters. Chapter 2 constructs a theoretical framework for analysing the politics of trade between SACU and China. It critically evaluates the assumption that bilateralism embodied in a SACU-China FTA would mutually benefit both parties and would ideally instigate further development in SACU. This chapter provides the theoretical underpinnings of the study. Liberal trade theory will be used to validate the pursuit of a SACU-China FTA. Structuralist analysis will also be used to unravel SACU's concern of being yet again on the periphery – this time in terms of the emergence of an economic superpower in the East. Since the world trade system favours exporters of manufactured goods (Khor 2001: 29), there is minimal value in trading primary commodities. Normative theory and structuralist views encapsulate tension between the trade relations of SACU and China.

Using the framework developed in the second chapter, Chapter 3 presents an empirical study of FTAs by examining the experiences of two developing countries:

- An analysis of the effect of NAFTA on Mexico; and
- An analysis of the effect of the TDCA on SA.

The purpose of this chapter is to induce relevant arguments that will highlight similarities in variables that will be identified in the relationship between SACU and China.

Chapter 4 presents a historical and descriptive analysis of SACU and its relations with China. The geo-politics of SACU's colonial legacy is examined to explain the irregularities in the region and how these dynamics transpire in diplomacy and trade. Since China became a member of the WTO in 2001, it has tactically sought to secure its access to fundamental resources needed to sustain its manufacturing capacity. This chapter captures the history of the parties' political alliance and increasing trade.

Chapter 5 examines the compatibility of Adam Smith's theory of comparative advantage in assuring or assuming that SACU and China would mutually benefit from an FTA. However, China's competitive advantage breaks the ideal equilibrium and trickle down effect of the 'invisible hand'. This chapter isolates the risks for SACU industries in the event that Chinese imports undercut their production and operations. South Africa, home to the region's corporate giants, only has some 20 companies based in China (Naidu 2005: Internet) whereas there are over 200 Chinese companies based in the SACU region. China is also recognised as a more competitive manufacturing hub. This chapter will thus analyse industrial-politico tensions between SACU and China, and the possible implications thereof.

The concluding chapter critically evaluates the findings of the study to determine the compatibility of the SACU and Chinese industries to mutually gain from an FTA without disregarding sustainable development interests. Based on these findings, recommendations will first be made on how SACU can better engage with China to ensure that its trade relations do not perpetuate further division of labour. Some general recommendations will be made on how SACU could create an environment that encourages domestic industrialisation that will be globally competitive and would promote economic growth and development in the region.

CHAPTER 2

INTERNATIONAL TRADE THEORY: BILATERALISM / MULTILATERALISM AND THE POLITICS OF TRADE

2.1 Introduction

In this chapter an analytical framework is developed, based on the theory and politics of international trade. It introduces critical issues that are pertinent to the implications of a possible free trade agreement between the Southern African Customs Union (SACU) and the People's Republic of China (PRC). As an introduction to the fundamentals, the focus of this chapter is international trade theory. The purpose is to provide a theoretical background to issues of trade in order to develop a framework for analysing the trade relations between SACU and China.

First, the chapter begins with a conceptualisation of trade. In the study of international relations and how countries engage, the distinction between the state and the market is not always clear. However, the Westphalian state system is the only legal institution with the authority to legislate national trade policies that are implemented in the market. Since trade is presumed to be the main generator of economic development and wealth, this chapter explores this justification and explains the role of trade in international relations.

Second, a study of international trade theory is conducted. The analysis incorporates three main perspectives: Economic Nationalism, Liberalism, and Structuralism. The first two provide contending normative theories of international trade, promoting certain ideals and interpretations of trade, as well as how and why it manifests the way it does. Structuralism, on the other hand, offers an empirical critique of the international trading system. For the most part, Structuralism identifies a discrepancy in the ethics of how trade is conducted. However, the various strands of structuralist theories each have different recommendations on how to rectify the supposed predicament.

Third is a critical analysis of the politics of trade. In spite of normative ideals provided by international trade theory, the empirical evidence suggests that both economic power and political power are variables of trade. This section explores the relation between politics and trade, offering an early premise for SACU's relations with China.

Fourth is the conceptualisation of bilateral and multilateral trade relations. This section provides a review of bilateralism and multilateralism vis-à-vis trade. Despite sharing the fundamental objective, which is trade, the realist and liberal theories of trade have conflicting ideals on the purpose thereof. In criticism of both their rationalisations, Structuralism presents a third contending theory to the notion of free trade. In geo-political terms, multilateralism tends to prompt the creation of some sort of regional organisation. A principle objective of numerous regional organisations is ultimately to implement a free trade agreement. Therefore, as a specific form of multilateralism, the notions of regionalism and regionalisation are subsequently introduced.

Fifth, a review of the contemporary institutionalisation of trade is provided, enabling certain theories of international trade to correspond with its practice. This section details the development of the former General Agreement on Tariffs and Trade (GATT) into the current World Trade Organisation (WTO) and provides an assessment thereof. The critique of the WTO reveals frustrations experienced by its members, particularly those of developing countries. The WTO's inability to harmonise certain issues, pertinent to developing countries, partially explains why many states and regional organisations are signing free trade agreements. Hence, authoritative representatives of SACU and China have publicly announced their intention to negotiate an FTA. However, in order to grasp the implications of such an FTA, it is necessary to evaluate the purpose of trade and what makes it so capricious.

In a globalised system international trade is the norm, for which there exists regulators. Yet, despite the existence of global trade institutions one may observe that an increasing amount of countries are cementing bilateral trade relations by means of a free trade agreement, which is the focus of Chapter 3. As an introduction, it is the objective of this chapter to provide a theoretical framework that will aid in discerning and highlighting a variety of variables, which render trade contentious. The fundamental purpose of this chapter is thereby to reveal the politics of trade between SACU and China.

2.2 International Trade: Distinguishing Between the State and the Market

The state, as a political institution, is also the only legal entity with a well-defined territory, population, and a government capable of exercising sovereignty. Trade takes place between states, but also between markets. The relationship between the state and the market is highly contentious in international trade theory, especially because it is also often blurred. Nonetheless, it is documented that the market emerged long before official states were ever established, and it continues to traverse across state borders. In contemporary international relations the market refers to an economic institution of the modern nation-state and/or a particular region. While the state holds itself accountable to its population, the market is dominated by self-interest and driven by competition. States enter treaties and engage in diplomatic relations; markets trade (i.e. import and export). Ever since the 17^{th} century when states began to gain greater control over their populations, their economies and their resources, the states also began to use their power to regulate the flow of goods, capital, services, knowledge and labour across borders (Pigman 1999: 194).

In simple terms, trade is the act of exchanging one good for another. When trade occurs in the international system the exchange takes place between states. It is also standard practice to measure the value of the product in monetary terms, in order to justify the exchange. Variables that determine a product's monetary value include quality, durability, composition, quantity and labour. Bearing in mind that certain countries have goods that other countries do not produce, one cannot disregard the justified purpose of trade. Therefore, in an international system where normative theory prescribes that states be self-sufficient, trade reveals certain vulnerabilities. It is from this notion that this chapter examines the politics of trade. The theoretical framework and study of politics in trade provides a critical foundation for the research into a possible SACU-China FTA and its implications on the region and its industrialisation.

As a collective realm, the state represents the actions and decision of its population. It is defined by geographical bearings and functions under an institutional system of rules and regulations. However, the market is comprised of individual actions. It is driven by human self-interest, the elusive forces of competition, capitalism and the pursuit to maximise profit earnings (Balaam & Veseth 1996: 6). Therefore, to what extent is the market free of the state and/or autonomous to state intervention? Although one's regime[5] can dictate the state's involvement in the market, this depends almost entirely on the value placed on the market. Wallerstein (1979: 66) also recognised the supremacy of the nation-state in his allusion that political units (the state) are not coextensive with the boundaries of the market. On the contrary, the state has the duty to distort the market, on the condition that its does so in favour of its industries. Therefore, instead of being a system of free competition for all, "competition becomes relatively free only when the economic advantage of upper strata is so clear that the unconstrained operation of the market serves effectively to reinforce the existing system of stratification" (Wallerstein 1979: 66). Therefore, it is the responsibility of the SACU countries' governments to serve the interests of their existing businesses/industries by creating a tailored market economy.

In *States and Markets* Susan Strange conceived that there are four global structures of international political economy – security, production, finance and knowledge. Trade forms part of the production structure, which is the sum of all arrangements that determine what is produced, by whom, for whom, by what means, and under what terms. Essentially, the outcome of the production structure is wealth; in the political economy wealth is a sign of power. As a result, the nationalist school of thought advocates that the production structure is the foundation of all organised societies (Balaam & Veseth 1996: 14; Strange 1988: 27 & 64). At a national level, states thus generate wealth through various means. Although the same principle is generally expanded to apply to a regional organisation, some parties of the organisation may be more reliant on others than vice-versa. Considering the fact that the majority of SACU's industrial capacity is based in South Africa (SA), SA thus accounts for a large portion of the region's production structure[6] (Roberts 2000: 615). However, how does SACU's production and/or wealth compare to that of China? Using the production structure as a basis of analysis, data is provided in Chapter 4 to comparatively assess SACU's economic relations with China (i.e. wealth, industries, trade, and foreign direct investment). In the interim, it is important to note that wealth is generated through industries and services. Therefore, an

[5] Examples of regimes or forms of government include anarchy, aristocracy, autocracy, communist, democracy, feudalism, monarchy, oligarchy, socialist, etc.

[6] The economic hegemony of South Africa in SACU is examined in Chapter 4.

inability of one party to competitively market its goods and services would directly affect its production as well as its wealth.

Trade is defined by some scholars as a means to an end, and even as an instrument used to obtain national power. These scholars claim that the objective of trade is to forge supremacy relative to others (Yarbrough & Yarbrough 1987: 25). One way of doing this is by establishing a monopoly of one's exports. Having a monopoly over the production of a particular item would reveal the vulnerability of one's trade partners, and thus strengthen one's own political power in the global trading system. Similarly, one may also monopolise services, using technical expertise and skill. In realist terms, although an official monopoly (of a product/service) may not always be possible, the prospects of establishing a *de facto* monopoly are fairly good.

Herewith is a hypothetical example of a *de facto* Chinese monopoly. According to the SA Department of Trade and Industry (DTI) nearly 42 percent of South Africa's imports from China are machinery, mechanical appliances, or electronic equipment (DTI 2007a: Internet). If this were also the case for the rest of SACU, one could deduce that SACU is also reliant on China to the extent that nearly half of its total imports from China are machinery, mechanical appliances and electronic equipment. The SACU states are certainly free to develop a regional manufacturing capacity of the relevant products, or source them from alternative markets. In an extreme situation, where there is lack of domestic production coupled with absolutely no imports from the rest of the world, China would have a monopoly in the SACU market for machinery, mechanical appliances and electronic equipment. In reality, Chinese products may not have a monopoly in the SACU market, but they are certainly more competitive and this makes SACU reliant on China. Using the argument against most monopolies, such a relation is inherently at risk of exploitation by the supplier and of overdependence by the consumer. The possibility of SACU becoming excessively reliant on Chinese goods is thus a plausible scenario, which may even be used as political leverage by China. SACU's economic reliance on China could be leveraged to induce political alignment on issues and in global forums, as it is customary in diplomacy for states to lobby using soft power in order to further their own interest. If trade is an instrument used to obtain national power, then the power may be used to serve certain interests. This brings to question the fundamental role of trade: is it to serve markets or the state?

According to Martin (1994: 61), as long as a Westphalian system dominates global trade politics the state will remain intertwined with the market, fusing to create what is referred to as a political economy. The reason why trade is so political, however, is mostly due to its association with security. As previously mentioned, international trade reveals vulnerabilities. Accessibility to certain scarce commodities thus provides the state (which serves its nation, which then forms markets) with a sense of security. In simple terms, the commodity may be projected as a national equivalent to a 'basic human need'. The role of international trade thus differs considerably from country to country. For a region like SACU, imports into the BLNS[7] states account for most of their state expenditures.[8] Similarly China's international trade differs from that of SACU, as it imports mostly input products and raw materials (DTI 2007a: Internet).

Although trade is important to all states, the value of products that are traded differs. Two countries may choose to manage their trade terms under a bilateral agreement. However when multilateral agreements evolve within a global sphere, there is space for institutionalising international trade. At the outset one must weigh the differing theories of international trade to better understand how states approach trade.

2.3 International Trade Theory

2.3.1 Mercantilism and Economic Nationalism

Mercantilism is one of the earliest perspectives of international political economy (IPE); it describes a state's role in the economy. Mercantilists believed that there was only a limited amount of wealth in the world, and therefore it was in the national interest of each state to secure its own share by restricting that of others. In contemporary political economy, this concept is referred to as a *zero-sum* game – where one's gain is another party's loss. However, during the seventeenth and eighteenth centuries, the group of professionals who conceived mercantilism were more introspective. They claimed it was a state's desire to maximise its wealth by producing trade surpluses. These early scientists believed that through national production of wealth a state would be able to finance its production and/or purchase of military weapons, which were a fundamental resource of state security (Gilpin 1987: 34; O'Brien & Williams 2004: 14). Although

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7 BLNS refers the South Africa's partners in SACU: Botswana; Lesotho; Namibia; and Swaziland.
8 Chapter 4 provides a comprehensive account of intra-SACU trade patterns.

there is no military threat imminent of SACU's relations with China, there is validity in the notion of a zero-sum game. Could China have more to gain at SACU's expense?

Two renowned advocates of the mercantilist theory elaborate on the subject of trade as a zero-sum game, namely Alexander Hamilton[9] and Friedrich List[10]. As one of the founding fathers of the United States of America (USA), during the 1770s Hamilton insisted that the USA protect its domestic manufacturers from foreign competition in order to strengthen domestic industrialisation. Nearly a century later, List prescribed that Germany industrialise behind trade barriers in order to catch up to the United Kingdom's level of economic success. Bearing in mind the zero-sum principle, List also rationalised that only countries with strong economies would promote free trade as others were most likely to lose out in competition (O'Brien & Williams 2004: 15). While bearing this in mind, an observation of relations between SACU and China indicates that since China has an economy almost 13 times[11] larger than that of SACU, SACU would stand to lose from a free trade agreement. However, this is only one perspective of trade and one cannot maintain with certainty that the zero-sum argument is still valid in the twenty-first century.

From the seventeenth up to the twentieth century, the notion of Economic Nationalism was increasingly embraced as a derivative of state security. National security was especially crucial during this time because of the rise of the nation-state and the increasing number of European states that began to claim colonies around the world. It was pivotal that through mercantilist principles states could ascertain means of protection (Balaam & Veseth 1996: 22). Similar principles of mercantilism in the twenty-first century are currently referred to as protectionist.

There are countless reasons why a state may choose to adopt a protectionist trade policy. The general argument would be to preserve a certain lifestyle that is absent of foreign

9 Alexander Hamilton (1755/1757-1804) was the first United States Secretary of Treasury, an economist and political philosopher (Britannica 2008a: Internet).

10 Friedrich List (1789 - 1846) was one of the leading German-American economists of the 19th Century. He believed that countries were to consider their individual requirements, as free trade could not be applied uniformly across nations at different levels of development (Britannica 2008b: Internet).

11 China's gross domestic product (GDP) in 2007 was US$ 7.043 trillion; SACU's combined GDP in 2007 was only US$ 510.922 billion (CIA World Factbook 2008)

influences. For this, states may even undertake autarkic measures to attain greater self-sufficiency – in military power, food security and employment (Heller 1968: 161). The mercantilists believed that the main objective of the state was to promote industrialisation, so as to ensure self-sufficiency. Therefore, protectionist trade policies would enable local industries to compete with those of foreign nations, especially in foreign markets (Gilpin 1987: 33). Given that there are trade barriers on certain Chinese imports, SACU's current trade policy is most definitely protectionist. Therefore, SACU's consideration to remove these barriers imposed on China implies that the region no longer needs protection – that the employment level, the profile of industrialisation and the region's welfare will not be negatively affected by Chinese influences.

The promotion of national industrialisation gave rise to a patriotic notion of Economic Nationalism. This emphasised the state's responsibility to use its economy to further its national interests. To date, neo-mercantilists believe that government should promote national industrialisation and protect its infant industries against those that are more mature. Essentially, in order to accumulate wealth and power, neo-mercantilists promote government intervention in the economy – both domestic and international (Balaam & Veseth 1996: 24). The government could intervene in the domestic market by imposing trade barriers on all imports. The barriers may either restrict the number of imports or subject foreign traders to import tariffs. Intervening in the international market, though foreign, must be channelled locally – e.g. offering state subsidies on export products/services.

Economic Nationalism was conceived during the late eighteenth to mid-nineteenth centuries. The goals of the state gradually expanded, once having been primarily to accumulate wealth and power, later included improving the socio-economic conditions of its population. Another one of the founding fathers of the USA, Alexander Hamilton, believed that developing an industrial capacity and a manufacturing base would require state intervention, i.e. trade protection. Accordingly, the USA introduced export subsidies to make its goods more competitive in foreign countries and instilled trade barriers to limit imports (Balaam & Veseth 1996: 27). The notion of Economic Nationalism also encouraged the state to produce more goods than it required (for export purposes) and discouraged it from importing goods, particularly consumer goods (Salvatore 1987: 14). Glancing over SACU's import profile, one may deduce that its production of consumer goods is at a deficit. Entering an FTA with China would encourage increased imports of consumer goods, which traditional mercantilists warn would be at the expense of the region in the long-term. By hiking the negative trade balance[12], SACU would be compromising businesses in the region as well as its industrial development. Although the traditional mercantilists only considered mineral resources as a form of national currency, neo-mercantilists recognise human resources and technology as a measure of national wealth.

Protectionist trade policies are important to the mercantilist because trade is understood to only benefit one party, it is a zero-sum game. Agricultural subsidies and tariffs are thus means of protecting national industrialisation and safeguarding employment. Free trade between countries is perceived to compromise the economy of the lesser-developed partner, exposing its infant industries to foreign domination (O'Brien & Williams 2004: 138). Infant industries, previously referred to as 'new' industries, comprise of companies that have been operating for eight years or less. Bearing in mind this definition, is the support for protectionism in SACU a warranted argument? To what extent are businesses in the region really 'infant' industries? Irrespective of liberal theory's claim that SACU needs protectionist policies to enable sustainable development and industrialisation, there are other perspectives on the matter. Critics of mercantilism contend that free trade, devoid of state interference, can be mutually beneficial to all its respective parties. With this in mind, the next section examines the liberal paradigm to international trade theory.

2.3.2 Liberal Paradigm

The liberal theory is the most dominant of trade theories, practiced by American, European and Japanese economists (Strange 1988: 179). Unlike Economic Nationalism, the liberal paradigm separates economics and politics from one another. It assumes that the market arises spontaneously in order to satisfy a human need, and thus exists autonomously under principles of a free market system devoid of state intervention

[12] A negative trade balance is when the value of a country's total imports exceeds the value of total exports. This is also referred to as a trade deficit. A trade surplus is referred to as a positive trade balance, which was according to mercantilists is a fundamental requirement for economic growth.

(Gilpin 1987: 27). The three main concepts of liberal trade theory are explored in this section: absolute advantage, comparative advantage and complex interdependence.

Smith's Theory of Absolute Advantage

Liberals believe that trade is a harmonising facet of international relations, claiming it offers mutual benefits and extends interdependence. According to Adam Smith, states will only trade voluntarily if they could both mutually gain from the exchange. It is from this premise of trade that Smith derived the notion of absolute advantage (Gilpin 1987: 31). Imagine two hypothetical states: if state A were to efficiently produce a commodity, but be less efficient than state B in producing a second commodity, then each state would be understood to have an absolute advantage over the efficient production of their respective commodities (Salvatore: 1987: 15). In a market economy that is driven by the law of demand, the concept of opportunity cost is thus fundamental to trade liberalisation. It was Gottfried Habereler who first explained that producing one commodity comes at the cost of not producing an alternative commodity (Heller 1968: 39). Therefore, by focusing one's attention on one commodity/skill, one is simultaneously deflecting one's prospects of producing another commodity and/or mastering another skill.

Liberal trade theory encourages states to focus on their best qualities. The theory claims that the only way to gain from opportunity cost is to trade one's commodity of specialisation – an exchange based on absolute advantage. This not only contributes to the efficient use of the world's resources, but as a result, also maximises the world's total income (Hoekman & Kostecki 1995: 21; Yarbrough & Yarbrough 1987: 13). The capitalist rationale is that resources, both human and capital, are more efficiently utilised when maximising profits and reducing costs. This formula may be instrumental in many national strategic plans, but in the international community states generally have similar industries and conflicting interests. How does one then explain trade between countries that produce and trade the same products?

Ricardo's Theory of Comparative Advantage

In the early 19th century, London financier David Ricardo supplemented Smith's theory by conjuring up the theory of comparative advantage. Although two countries may both produce certain products, Ricardo suggested that each country should specialise in producing and exporting the commodity for which it has the smallest absolute disadvantage. Similarly each country should also import the commodities for which it has the greatest absolute disadvantage (Salvatore 1987: 18, Strange 1988: 179). Here the notion of opportunity-cost is more suitably utilised. Although two or more countries may each produce the same product, their costs of production will differ. The cost of production is mainly determined by the cost of input products and labour. As such, the cost of manufacturing textiles, clothing and footwear (TCL) products in China is different from its cost in SACU. Similarly, the cost of producing energy products in SACU is different from its cost in China. If each party were to focus on its comparative advantage, it should efficiently allocate its resources thereby maximising its productivity and profits. However, how accurate is this premise?

Ricardo claims that parties should simultaneously gain from free trade by trading their product and/or service of comparative advantage (O'Brien & Williams 2004:139). Each state should provide others with products and/or services that they are less competitively-able to produce. For instance, SACU countries are better equipped to produce more raw materials than China, and China is better equipped to produce certain manufactured goods than the SACU countries. Ideally, if each party were to focus on their strengths, then they would mutually gain from an FTA. However, the trade-off is not as simple. Their products of specialisation are not of equal value. Their monetary rates differ and they are channelled into different distribution chains. One is trading a finished product, ready to be sold directly in the market to the end-consumer. Yet, the other is trading cheap raw material that can only quadruple in value after export and processing. What then are the long-term implications of such a trade-off?

Complex Interdependence

Mutual gain from comparative advantage trade is what Keohane and Nye (1989: 24) marked as a relationship of complex interdependence. This is only possible because even though one state may have absolute advantage in respect to another state in the production of various commodities, there remains a basis for mutually beneficial trade. Despite each country's ambitions for Economic Nationalism and self-sufficiency, there is still recognition of their mutual interdependence. Each party is endowed with different resources and factors of production. In the context of trade relations between a developed country and a developing country, the former is generally more endowed with capital while the latter is endowed with labour. Therefore, capital-intensive products will be produced in the developed country for local consumption and export; labour-intensive products will then be produced in the developing country for local consumption and export (Strange 1988: 180). Furthermore, Wallerstein's (1979: 109) interpretation of the world economic system may also be used to describe the global division of labour. At the core/global North, there is mostly capital-intensive means of production and the labour is highly sophisticated. On the contrary, in the periphery/global South the means of production are mostly manual and labour-intensive (Wallerstein 1979: 38 - 39). However, when applying these theories to SACU-China relations the distinction is skewed, since China is endowed with more capital as well as labour. The SACU region is therefore at a great disadvantage in this regard. China has the capital resources necessary for sophisticated manufacturing, as well as ample supply of human resources to undercut competitors in cheap manufacturing. SACU's only comparative advantage, as a peripheral state, is in its supply of raw material and natural commodities.

2.3.3 The Structuralist View of Trade

The structuralist view of trade is heavily influenced by the work of Karl Marx (1818 - 1883). Having interpreted Marx's writings, Marxist scholars have derived a theory of economics, politics, sociology and ethics that is referred to as Marxism. It juxtaposes the conflicts and contradictions between the forces of production in an economy and the relations of production in a society. Marx's observations led him to believe that there were two types of people in 'production': the capital-owning bourgeoisie; and the labouring proletariat. Furthermore there would remain a perpetual imbalance of power, as only the owners of production and capital would accumulate power.

From Marxism to Imperialism

According to Marxism, the relationship between the bourgeoisie and the proletariat would endure much strain. The bourgeoisie's competitive drive to maximise profit would lead to the exploitation of its workers, the proletariat. As a result, more wealth would accumulate amongst the bourgeoisie, as members of the proletariat were made redundant by improved technology and mechanised labour (Gilpin 1987: 37). Marx anticipated the system to result in mass proletariat desolation, which would ultimately set the scene for a revolution and the demise of capitalism. However, capitalism subsisted. According to Vladimir Lenin[13], colonisation enabled the bourgeoisies in Europe to expand their pool of workers, using imperialism to further their capitalist interests (Balaam & Veseth 1996: 67).

Gilpin (1987: 41) states that Lenin's theory of capitalist imperialism became the orthodox Marxist theory of international political economy. This was later to be dubbed Leninism, according to which profit-seeking capitalist states exploit the world's poor peripheral countries. As the rich states get richer, the burden of underdevelopment falls upon the poorer nations. With minimal value being given to producers of primary commodities (Khor 2001: 29), poor states depend on the rich ones for manufactured goods, financial resources and jobs. In normative theory, as proposed by liberal scholars, the relationship between the rich state and the poor state should be of interdependence where trade is mutually beneficial. However, structuralists argue that empirically the relationship will be of dependence, exploitation and uneven development (Balaam & Veseth 1996: 69). The Marxist school of thought is thus categorised under Structuralism because Marx's views of economic structures in domestic societies are used to describe the economic structures amongst nations in the international system. As Marx understood certain people to be trapped in the production structure, similar views are expressed about the position of certain states in international trade. Each country's specialisation in production is viewed as a division of labour.

Dependency Theory

Structuralism does not refute the liberal view that certain individuals possess specific skill and that certain firms specialise in particular products and therefore certain countries may have an advantage in production. Structuralism reiterates that there is an unequal distribution of wealth and power within the international capitalist system. It is born of the assumption that the market is not neutral; history and the uneven distribution of economic wealth in the world have created a bias against developing countries of Africa, Asia and Latin America (Strange 1988: 181). Furthermore, institutions related to global capitalism are similarly concurring of the dominant powers, and consequently endorse and perpetuate the system (Balaam & Veseth 1996: 70). Immanuel Wallerstein's

[13] Vladimir Ilyich Lenin (1870 - 1924) was a Russian revolutionary. Founder of the Russian Communist Party and the inspiration behind the Bolshevik Revolution (1917), Lenin was the fist head of the Russian Soviet Socialist Republic (USSR) between 1917 and 1924 (Britannica 2008c: Internet).

theory of the modern world system provides an extension of the above. In *The Modern World System*, Wallerstein (1974: 63) categorises states into three fundamental units and describes them as follows:

- The core: the states conduct highly-skilled industrial activity and modes of production;
- The semi-periphery: intermediary between the core and the periphery; and
- The periphery: states that export primary commodities.

Dependency theory is another variant of the structuralist approach to trade. It proposes that the structure of the global economy makes the capitalist nations of the 'North' enslave the less developed countries of the 'South' by creating a perpetual system of dependence. According to Falk (1999: 13 & 17) several interpretations of the system have referred to it as a kind of global apartheid. This reiterates the notion that the global South is considered to assume a position of servitude to the 'North'.

Strange (1988: 181-182) writes that certain economists believed the global economic inequalities were a mere reflection of the inequality intrinsic to the capitalist system that is sustained by political power at a domestic level and in foreign markets. Therefore the global division of power is inevitable. However, since the SACU countries and China are all categorised as developing countries and even emerging markets in their respective regions, it is the empirical application of Wallerstein's model that could reveal interesting features about the economic relations between SACU and China.

As more data and analysis are provided over the next few chapters, it will become more evident why the possibility of a free trade agreement between China and SACU is highly debated. Certain scholars and trade analysts have observed a trend in the nature of trade between both regions that insinuates 'structuralist' characteristics.

2.4 The Politics of Trade: Winners and Losers

In Susan Strange's *States and Markets*, she argues that in order to study international political economy one must pay particular attention to the role of power. It is power that determines the relationship between authority (the state) and the market. It is important to identify who has power and what is the source of the power. Furthermore, one must distinguish between moral authority and the possession of great wealth. Power derived from moral authority tends to be elusive, stemming from a proclamation and general acceptance of compelling ideas and principles. However, wealth offers purchasing power and means of production. These two features are also referred to as political power and economic power. The challenge in international political economy is that in trade the distinction between political power and economic power is often blurred, hence the politics of trade (Strange 1988: 21 - 25).

States and markets are increasingly active in the international community. Globalisation has revolutionised industry, as the production process of consumer goods are increasingly fragmented/delegated to different companies that may also be in different countries. How much power can the state really hold in this instance? Ultimately the power of the state has always been dependent on the wealth and productivity of its society, its industries and its market (Grieco & Ikenberry 2003: 9). By deduction, since China has more 'power' than SACU, it will have more leverage during the FTA negotiations. Therefore, SACU's liberalisation may not be guided by the region's need to protect local business or its aspirations for new industrialisation. Instead, the liberalisation (increased trade) may be clouded by power politics.

Strange (1998: 165) argues that international trade is not proactive, but is instead reactionary. It is caused by demand and forces in the market place. Strange claims that international trade is dependent on the four power structures: security, production, finance and knowledge. Therefore international trade is the result of networked bargains that are partially economic and partially political. The bargains involve trade-offs of security interests (welfare) and commercial interests (wealth). The state thus continuingly assesses the socio-economic impact of trade and FDI on its local labour force, existing industries and prospects for new development (Grieco & Inkenberry 2003: 11). Deductively, whatever trade-offs SACU chooses to make in the event of an FTA with China, they are likely to impact the region's wealth, as well as its welfare.

2.5 Bilateral and Multilateral Trade Relations

2.5.1 Bilateralism and Trade

In traditional political economy bilateral trade was trade between any two nation states (Salvatore 1987: 237). In modern international political economy the definition is no longer restricted to the traditional Westphalian state system; it simply involves two economic parties. Pertinent negotiations take place in order to concur on rules of conduct, reduce barriers to trade and resolve differences. Considering that a fundamental purpose of trade is that of market access for a particular good and/or service, it is implied that one party is lacking a product and/or service that the other party possesses. Therefore, trade takes place between relatively unequal parties. Furthermore, despite references to complex interdependence, one party is generally considered 'smaller'[14] than the other. Such a small state may choose to impose trade barriers in order to generate local industrial capacity. This would not only ease the environment of business for its local industries, but also provide a revenue stream through import tariffs.

Market protectionism, however, does not always work the same for all states. With fierce competition in the global market a small state that fails to influence global prices would not benefit from imposing trade barriers. Its consumers would be the ones to pay the high cost. However, under a multilateral agreement such a small state would instead profit from lower trade barriers (Hokman & Kostecki 1995: 20 - 21). Therefore, although not imposing trade barriers may be imprudent in the global market for a small state, it is highly recommended in restricted multilateral agreements.

Figure 2.1 outlines the sequence of trade relations that ultimately develop into much more definite forms of regional integration. Initially states typically agree to certain terms of cooperation for a specific sector and/or sub-sector. Both the scope and intensity of cooperation chronologically progress as tabled below. The focus of this chapter is on the free trade agreement, while the next chapter examines the history of the Southern African Customs Union and its economic principles for regional integration.

[14] The notion of a smaller economy refers to one that has a lower gross domestic product than another.

Figure 2.1: Sequence of Trade Relations and Regional Integration

Bilateral/Multilateral Trade Agreements	Removal of internal quotas & tariffs	Common external customs tariff	Free movement of land, labour, capital and services	Harmonisation of economic policies and development of supra national institutions	Unification of political and super national institutions
Sectoral Cooperation	○				
Free Trade Area	●				
Customs Union	●	●			
Common Market	●	●	●		
Economic Union	●	●	●	●	
Political Union	●	●	●	●	●

Source: Gibb (2001: 73)

Sectoral cooperation between countries/parties involves the selective removal of trade barriers between the parties to the agreement – e.g. the African Growth and Opportunity Act (AGOA).[15] In a free trade area the members remove all trade barriers amongst themselves, but retain their individual trade barriers with non-members – e.g. the North American Free Trade Agreement (NAFTA). In a customs union, like SACU for instance, the members remove all trade barriers amongst themselves but also harmonise their trade policies and trade barriers on trade with the rest of the world. A common market employs the fundamental principles of a customs union with the added feature of allowing the free movement of land, labour, capital and services between the members (Salvatore 1987: 260).

An economic union of states includes all features of a common market as well as the harmonisation of economic policies and the development of supra national institutions. This may entail the financial harmonisation of currencies and perhaps even the introduction of a common currency. In a political union the members partially surrender their political sovereignty by unifying all national institutions to establish super national institutions. The EU is the world's most consolidated modern example of a political

[15] AGOA provides 39 African countries with trade preferences and duty-free entry into the USA for certain goods – e.g. textiles and apparel goods, horticulture products, automotives and steel (AGOA: Internet 2008).

union. It has 27 member states, located primarily in Europe. The EU is internationally recognised as one single market, and 15 of its member states have adopted a common currency – the euro (EUROPA 2008: Internet).

Economic/trade relations between two parties willing to liberalise their markets generally follows the sequence of integration illustrated in Figure 2.1. Bilateralism, which technically involves two parties, can thus take form in three scenarios:

- Between two countries, e.g. China and South Africa; or
- Between one country and a regional organisation, e.g. South Africa and EU; or
- Between two regional organisations, e.g. EU and SACU.

The prospect of a SACU-China FTA would therefore fit into the second category. What complicates this form of bilateralism is the fact that one party is a regional organisation comprising several members. Regional integration arrangements (RIA) in the contemporary international system tend to either be a customs union or a free trade area. These are both preferential trade areas, where lower tariffs are imposed on goods produced in the member countries, compared to those produced in the rest of the world (ROW). In a free trade area the tariff on goods produced by the member countries are eliminated, whereas in a customs union the tariffs of members are harmonised to impose a common external tariff on goods produced in the ROW (Piazolo 2002: 1203). By deduction, a SACU-China FTA would entail an elimination of SACU's common external tariffs on Chinese imports.

2.5.2 Multilateralism and Trade

The fundamentals of multilateralism outlined in this section set a precedent for the study of SACU in the next chapter. Although SACU is contemplating to liberalise its bilateral relations with China, one most recognise the foremost multilateral relations between SACU members. Multilateralism is an approach to international trade and security, based on the premise that co-operative regimes must represent a broad and sustainable consensus among states (McLean 1996: 328). Multilateral cooperation between states thus occurs through a shared regime or the establishment of an institution. Due to the anarchic nature of the international system, political scientists claim that a regime may be necessary to regulate international relations. A regime is referred to as a set of principles, rules, norms and decision-making procedures. Although the regime may not be enforceable through a transnational hierarchical legal system, its mere endorsement implies a certain appreciation and obligation (Hokman & Kostecki 1995: 20). Adopting a regime therefore requires that states share common interests, e.g. free market capitalism. However, a regime is only a soft form of regulating multilateral trade relations. It is in the establishment of institutions that concrete policies may be ratified. For instance, as is examined in the next chapter, the member states of SACU are historically linked by a shared regime. However, SACU owes its capacity to function today in the international system to its set of principles and regulated institutions.

Liberal institutionalism advocates that regulating multilateral trade relations in an international system demands the creation of an international trade organisation, e.g. the WTO (Scholte, O'Brien & Williams 1999: 162-163). This liberal approach to multilateral trade relations is based on a perceived recognition that states are mutually interdependent, which is the rationale for stability and cooperation. However, the realists have an opposing disposition, where interdependence may be perceived as a liability.

According to Realist scholars, stability in the anarchic system is fundamentally based on a balance of power. Then, the end of the Cold War shifted dynamics and fuelled a contentious debate over the future of world order. Each state had to re-evaluate its position in the international system, devoid of an allegiance to the USA or the former Union of Soviet Socialist Republics (USSR) (Stubbs & Underhill 1994: 333). Furthermore, negative trade balances prompted countries to reconsider their trade policies – bilateral and multilateral relations as well as prospects for regional integration arrangements (Busch & Milner 1994: 259). Developing countries, in particular, diverted their attention to regional geo-politics. In the SACU region, for instance, South Africa's apartheid regime had always secluded the region from the rest of the world. The end of the Cold War and the subsequent collapse of the USSR set a precedent for reform and democratisation in South Africa. A comprehensive historical analysis of SACU is outlined in the next chapter. In the interim it is important to note that this period was also significant to SACU, as is led to greater integration of the organisation.

There are many changes one may observe in the world, of which a few of them also appear contradictory. The rapid trend towards globalisation is creating interconnections between states and other parties[16] at varied levels – social, economic and political (Gamble 2001: 21). Also, at the same time there is an increasing amount of regionalisation of economic activities and strengthening of bilateral relations between states. The quality of political relations is defining the terms of regional integration and/or economic relations and trade. For instance, the trade policies of a country dictate its import and export partners. In the event of deteriorating political relations, the supply of and/or market for specific goods would be threatened. As such, states may either choose to consolidate their relations through regionalism or seek multiple trading partners to diversify their sources/markets (Busch & Milner 1994: 267). For SACU, the BLNS countries import mostly from South Africa, which is increasingly importing goods from China. This trend concurs with the official launch of South Africa's diplomatic relations with China in 1998 and the expressed enthusiasm by both parties to cooperate on international issues of mutual concern (DFA 2004: Internet).

2.5.3 Regionalism and Regionalisation

Regionalism has become a distinguishing feature of international relations and contemporary trade politics, but its definition remains elusive. For geographers the term regionalism refers to sub-national regions, such as the Mpumalanga Province in SA, or localised economic clusters, such as the Lowveld in Mpumalanga. However, in IPE the geographical threshold of regionalism crosses various levels – national, bilateral, or even multilateral. As such, its definition remains disputed (Hocking & McGuire 1999: 227). An examination of regionalism and regionalisation is included in this chapter to provide an analytical framework of the model of integration employed in the SACU region.

According to Gamble (2001: 27) regionalism is a type of state project, often considered a coping strategy and/or a response to globalisation. Although different schools of thought each have differing interpretations of regionalism, they all recognise the fact that a distinctive factor of the emerging global order is the consolidation of regionalist projects, e.g. the European Union (EU), the South African Development Community (SADC), and SACU amongst others (Gamble 2001: 24).

16 Non-governmental organisations, international financial institutions, multinational corporations, etc.

There are three main dimensions of regionalism for countries in a definable geographical area:

- The countries may share a significant historical experience;
- The countries may have developed socio-cultural, economic and/or political relations that distinguish them from the rest of the world;
- The countries may be party to an organisation that manages issues of their collective affairs (Stubbs & Underhill 1994: 331-332).

Certain scholars claim that these three dimensions are interrelated and may not occur in isolation. In SACU, this may certainly be the case. However, in IPE only the second dimension is of significance. Trade analysts claim that regional economic relationships are natural and also inevitable, especially due to proximity. Businesses that are close to their markets have lower logistical costs. They are also familiar with the environment of business – practice, etiquette, utilities, etc. Therefore, businesses that are internationalising generally invest in neighbouring countries (or near) before embarking on a global strategy (Hocking & McGuire 1999: 227). Relations, whether socio-cultural, economic or political, they facilitate the regionalisation process.

In IPE regionalism is not confined by geographical proximity. The core members of a regional organisation may be situated in a particular region, but in theory the boundaries are not continentally exclusive. Morocco, for instance, is situated in the Maghreb region and on the fringe of the Atlantic Ocean. However, on occasion it is considered part of the Middle East and is party to associated organisations – e.g. the League of Arab States and the Greater Arab Free Trade Area, amongst others.

Regionalisation is a process of social change whereby state and non-state actors exhibit distinctive new patterns of social interaction (Gamble 2001: 27). This concept reiterates issues that were raised in the previous chapter, i.e. when politics is channelled through the state, the state is invigorated as an important instrument through which the global economy develops and is institutionalised. The relationship between regionalism and multilateralism is not clear. Certain scholars claim that the two clash, while others believe that regionalism may actually be a form of multilateralism. Multilateral arrangements on a global scale aim to remove trade barriers between states.

Regionalism, by contrast, distinguishes a group of countries from the rest of the world (Hocking & McGuire 1999: 227). Hence the argument that regionalism impedes multilateralism and the performance of the WTO. However, it is difficult to quantify the effect of regionalism on trade and sustainable development.

A realist scenario of regionalisation assumes that states form partnerships in order to compete with other states and/or partnerships. A typical zero-sum game arises where the blocs (partnership of states) competes with one another to increase their respective shares of territory, market access, resources, and wealth within the global total. As a result the pressure on each bloc to become more cohesive is directly related to the success of other blocs in unifying themselves (Gamble 2001: 26). Essentially, regionalisation is a state policy that is based primarily on the principle of maintaining a competitive advantage. In contrast, the liberal school of thought offers a much different interpretation.

A liberal scenario of regionalisation assumes that states could mutually gain from one another. Liberal institutionalists proclaim the world economy is interdependent. It is only rational for states to therefore prefer cooperation instead of conflict. Liberals argue that in the contemporary global society, states are frequently facing issues that transcend beyond national borders. Consequently there is a need for rules and institutions to track, to arbitrate and to regulate transnational issues. In contrast to the realists, the liberal interpretation inhabits a positive-sum view of regionalisation (Gamble 2001: 27). States could thus cooperate either through competition or negotiation in order to increase the total number of goods available for distribution. In addition to their entangled history, this assertion is especially relevant to the BLNS countries.

Early structuralist interpretations of regionalisation refer to ultra-imperialist underpinnings in the global economy – the joint exploitation of certain blocs by the united economies of the world's great powers (Gamble 2001: 27). But is there substance in the accusations brought against the OECD countries and the Bretton Woods institutions? Is it their intention to jointly exploit the Global South? Over the last three decades the world's great powers have advised developing countries to adopt western development models and to liberalise their markets. However, the adverse effect of the structural adjustment programmes (SAPs) in several African countries remains a highly controversial subject. Could market liberalisation, through the SAPs, have been a form of exploitation? What does this imply for FTAs of unequal partners – i.e. between a developing country and one that is already developed?

The fundamental core of bilateral and multilateral trade relations, which is often channelled through regionalism, is the elimination of trade barriers between respective parties. Yet, this may raise several challenges for developing countries. The African, Caribbean and Pacific (ACP) group of states[17], for instance, proclaim that the EU's proposed economic partnership agreements (EPAs) should address the dynamics of their developmental process. They demand that the EPAs be enabling of economic growth, sustainable development, poverty reduction, and the gradual integration of their countries into the global economy (Makwavarara & Deve 2005: Internet). The ACP group of states therefore recognise that EPAs, much like FTAs, could impede their development efforts and should therefore be negotiated with reservations. Therefore, although the intention of an FTA is to generate increased earnings by facilitating trade, the concomitant consequences of market liberalisation for a developing country could be detrimental.

2.6 Institutionalising International Trade

In an anarchic international system, institutions are created to manage diplomatic and economic relations. An international trade institution is a catalyst used to harmonise the trade policies of consenting members. This dissertation examines the most comprehensive international trade organisation – from its inception as the General Agreement on Tariffs and Trade (GATT) to its current standing as the World Trade Organisation (WTO). The purpose of this section is to demonstrate its shortcomings; hence the apparent need of SACU and China to negotiate a bilateral FTA outside WTO parameters.

[17] African, Caribbean and Pacific (ACP) group of states are the signatories of the Lomé Convention, signed in Lomé (Togo) in 1975. The Lomé Convention is succeeded by the Cotonou Agreement, signed in Cotonou (Benin) in June 2000.

2.6.1 The General Agreement on Tariffs and Trade

After the end of the Second World War a post-war structure of the international political economy was formulated at Bretton Woods, New Hampshire in 1944. Under the guidance of the USA and the United Kingdom (UK), the allies attempted to create a new monetary order. Since they had failed to launch the International Trade Organisation (ITO), the GATT was subsequently established in 1948.

The purpose of the GATT was to oversee the liberalisation of international trade. The process of trade liberalisation took place through a series of multilateral negotiations, referred to as GATT rounds. Typically the world's key traders would bargain to reduce their protectionist barriers in exchange for market access in other countries. Although reciprocity was the initial intention of the GATT, it subsequently adopted an MFN policy – one state would give another an advantage against all others by reducing tariffs on the other state's products. However, despite the GATT's intention to administer world trade, up until the 1980s its membership was restricted to willing liberalisers (Balaam & Veseth 1996: 112).

The GATT's membership consisted of countries from the Organization for Economic Cooperation and Development (OECD) and very few developed countries. Reciprocal trade negotiations thus only took place amongst the OECD countries, while the developing countries were granted special and differential treatment (SDT) status. The developing countries did not have a genuine interest in reciprocal liberalisation because they did not have much to offer. Therefore, negotiating reciprocal non-preferential agreements would have been inconsistent with their SDT status (Collier 2006: 1428).

Of the OECD countries there were three dominant players – the USA, the EU and Japan. Between these countries the scope of the GATT's agenda for trade liberalisation was restricted to one main sector, manufactured goods, which facilitated reciprocity. Trade liberalisation offered each these countries the opportunity to maximise profits from economies of scale. The competition enabled the efficient allocation of resources and prompted quality production of high-tech specialised goods, all without contracting the sector (Collier 2006: 1425 & 1427). The previously perceived threat to employment was replaced with increased investment which only added value to human resources and knowledge. In this effect, trade liberalisation between OECD countries (for manufactured goods) had virtually removed all tariff barriers during the GATT's reign. Considering the GATT met its objective (amid its restricted membership and the confined agenda), it is recognised as having been a successful organisation.

After the 1960s sequence of independence of African countries, the principles of trade liberation began to be applied in new frontiers. The Bretton Woods institutions recommended that developing countries adopt SAPs, which liberalised their markets and cut down public welfare programmes. Ironically, the trade liberalisation was non-reciprocal, especially in areas that had the greatest prospects. Bearing in mind GATT's focus on manufactured goods, market liberalisation only paved the way for a negative trade balance in African countries. The GATT's limitation was its inability to accommodate the countries' complimentary interests in varied sectors. Note that the GATT never attempted to negotiate the liberalisation of the agricultural sector. As such, Collier (2006: 1425) notes that between the OECD countries, liberalising the trade of manufactured goods was relatively easy. The GATT effectively began to face challenges as its scope of trade liberalisation expanded. This was further exacerbated after the collapse of the Union of Soviet Socialist Republics (USSR) in 1991, as more developing countries emerged into the international community. From its initial conservative membership, by the early 1990s the GATTs membership had risen to 128 countries (Hocking 1999: 7). As the principles of the GATT became increasingly invalid to its growing pool of members, countries recognised the need to renegotiate terms of trade and the policies that govern them – hence, the launch of the WTO.

2.6.2 The World Trade Organisation

2.6.2a A Historical Overview

The World Trade Organisation (WTO) was established in 1995 from the Uruguay Round of trade negotiations. Its main function is that of ensuring trade predictability amongst nations, which is to be done in a free, fair and smooth manner. The organisation supervises the following duties:

- Administer trade agreements;
- Act as an arena for trade negotiations;

- Settle trade disputes;
- Review national trade policies;
- Assist developing countries in trade policy issues through training; and
- Cooperate with other international organisations (WTO 2007: Internet).

There are 153 members of the WTO, thus accounting for almost 97 percent of the world's trade (WTO 2007: Internet). Both China and all five SACU countries are members of the WTO. The organisation has a democratic voting system, one vote per country. However decisions are mostly made by negotiation and consensus. Therefore despite condoning the 'majority voting system', the WTO has never made use of it.

The WTO comprises of three main bodies: the Ministerial Conference; the General Council; and the Goods Council, Services Council and Intellectual Property Council. The Ministerial Conference is the highest authority in the WTO, it meets at least once every two years. The General Council consists of mostly ambassadors and head of delegations, who meet several times a year at the WTO headquarters in Geneva. The WTO Secretariat is also based in Geneva and is headed by the director general. Its main function is to provide administrative and technical assistance to the WTO's councils and committees (WTO 2007: Internet).

The bulk of the WTO's general agreements emanate from the 1986-1994 GATT Uruguay Round negotiations, of which the five main ones the following: the trade of goods, services and intellectual property, the settlement of disputes, and policy review mechanism. Regarding trade matters, the WTO ensures that the agreed rules are abided. Some rules are case-specific to the agricultural and textile sectors, whilst others deal with issues surrounding "state trading, product standards, subsidies and actions taken against dumping" (WTO 2007: Internet). Since 1995 the WTO has made no major amendments to the rules pertinent to the trade of goods. However the new General Agreement on Trade Services (GATS) now also provides free trade rules for all businesses in the service sector. In 1980 manufactured goods accounted for 23 percent of world production and services accounted to 53 percent. Yet by 1994 the figures shifted to 21 percent and 63 percent respectively. According to Hocking (1999: 7) this adjustment is due to increasing amounts of foreign direct investment (FDI). This indicates an early shift in the focus of global trade away from mere trade of goods to an increasing demand for services in-market (to generate local development). This is a growing trend amongst emerging economies, especially in the relations with developed countries that have established economies.

The Trade-Related Aspects of Intellectual Property Rights (TRIPs) and the Trade-Related Investment Measures (TRIMs) are both policy frameworks of the WTO that serves to protect its members' intellectual property rights (IPRs). Unlike the GATT, which only prescribed rules and regulations that its members voluntarily complied to, WTO member are duty-bound to harmonise their national laws with TRIPs and TRIMs (Capling 1999: 79). However, not all countries that recognise IPRs are able to enforce their regulation due to lack of administrative capacity. Regulating IPRs requires sophisticated structures, technical expertise, and a reliable judicial system (Capling 1999: 79 & 81).

Intellectual property rights comprise of two main categories: industrial property rights and copyright. Industrial property includes inventions, novel ideas, packaging, emblems, logos and ornamental designs. These are protected by *patents, registered designs* and *trademarks*. However, *copyright* protects only the finite expression on an idea that is set in literacy as well as in artistic or musical works – e.g. in a compact disk, digital video disk, a film, a book or even a photograph. For a developing country, the implication of IPRs is that instead of paying the market prices for a product, it will be paying an inflated 'monopoly' price for consumer goods – e.g. food, drugs and books (Capling 1999: 80 & 91). For instance, pharmaceutical companies have the right to sell their medicines at 'monopoly' price. However, this issue becomes highly contentious when one considers the number of consumers around the globe who continue to suffer and/or die because they cannot afford the medication.

The WTO makes use of the Dispute Settlement Understanding to resolve all trade disputes between its member-states. A protocol is followed when countries present their disputes before the forum. Additionally, the Trade Policy Review Mechanism is used to evaluate the impact and efficiency of trade policies adopted by the WTO. This process encourages transparency within the organisation, as well as a forum for constructive criticism (WTO 2007: Internet). Yet, with all these institutional guidelines in place, the principles and practices of international trade continue to clash. Countries are at differing stages of development and thus have clashing national interests; hence the Doha Round is in its seventh year.

2.6.2b The Doha Round and its Development Agenda

Since the launch of the Doha Round in 2001, progress from the negotiations has been slow and irregular. According to the original timetable the Doha Round was supposed to have been concluded by December 2005 (Carim 2006: 4). However, when the WTO's meeting in Cancun came to a staggering halt in 2003, this set a new tone to the negation process as representatives of developing countries walked out of the meeting to demonstrate their contempt. Negotiations resumed a year later in July 2004, only to collapse once again in mid-2006 because the countries could not agree on key issues. Since the negotiations recommenced in 2007 and are far from conclusion, evidently the Doha Round has been the WTO's most challenging round of trade negotiations. Collier (2006: 1426 & 1430) believes this to be the case because its agenda is overwhelmingly focused on developing countries, hence why the Doha Round has been dubbed the 'development round'. While the GATT's agenda was predominantly about intra-sectoral trade liberalisation between the OECD countries, the Doha Round illustrates that inter-sectoral trade liberalisation between countries at different stages of development is challenging.

The negotiations collapsed again in July 2008 when ministers from key economies (namely the EU and the USA) failed to agree on technical issues, regarding the proposal of an emergency tool to shield poor farmers during import surges. Although there has been speculation of resuming talks towards the end of 2008, analysts suspect that the multilateral talks can only fully resume after the USA's 2008 presidential elections after which the country's position on the Doha Round my alter. In the meantime, senior officials and the group of advanced industrialised nations (Group of Seven / G7 / G-7 is a meeting of finance ministers from Canada, France, Germany, Italy, Japan, United Kingdom and USA) continue to meet several times a year to discuss economic policy reform (Reuters India 2008: Internet).

Although there are several reasons why the Doha Round has been stagnant, a central feature is agriculture. With over seventy percent of the world's poor living in rural areas, subsistence farming has the greatest potential for export growth and development. Yet, these prospects are distorted by agricultural export subsidies, amongst other trade barriers. From South Africa's Department of Trade and Industry (the DTI), Chief Director of Trade Policy and Negotiations Mr. Xavier Carim claims that "[r]*emoving these anti-development measures remains a core objective of the round and progress on other aspects of the DDA [Doha Development Agenda] rests on progress in agriculture*" (Carim 2006: 5).

Self-sufficient means of providing food security is an essential component of Economic Nationalism. For the OECD countries, the agricultural industry is thus preserved at all costs for reasons of political security (power) and economic sustainability (welfare) (Collier 2006: 1430). Furthermore, analysts claim that developing countries should recognise that trade restrictions are used to protect the welfare of domestic markets and are thus pro-development at the core, irrespective of evidence to the contrary. Hence, the aspirations of the WTO members remain dichotomous.

Representing the interests of the developing countries, the Group of 20 (G20)[18] demands the EU and the USA reduce their tariffs in order to enable G20 exporters to gain market access to their economies devoid of trade barriers and distortions. The positions taken by the EU and the USA in response to the above are crucial to Doha's agricultural negotiations. After tabling a series of proposals, the EU finally agreed to eliminate all its exports subsidies by 2013. As for the USA, its proposed concessions have been considered unsubstantial (Carim 2006: 6). However, the USA's resistance to liberalise its agricultural sector at the expense of its domestic welfare demonstrates its loyalty to its republic. Although globalisation has revolutionised the way in which governments, markets, MNCs and civil society interact with one another, the state remains the only legal and accountable entity in the global system. Realists, therefore, insist that its loyalty and responsibility is towards its people. If the Doha Round fails to resolve the pending disagreements (especially concerning agriculture), then the existing trade system will remain. As a result, the developing countries would lose their opportunity to

[18] The G20 comprises 20 developing countries of the Global South, and includes South Africa.

persuade Japan, the EU and the USA to lower their trade barriers and agricultural subsidies, as well as lose the proposed special safeguards that are part of the Doha deal (Lynn 2008: Internet).

The WTO is a liberal institution whose sole purpose is to promote market liberalisation. But does market liberalisation demand an appreciation for socialism? How valid is the argument for free versus fair trade? The only fault of liberal theory, which the WTO intrinsically subscribes to, is its confidence in the market's invisible hand to evenly distribute the world's resources and wealth. By adopting a development agenda to trade, the WTO abandoned liberal trade theory and has charted into ambiguous territories. In fact, the relationship between liberalisation and growth is uncertain. Several studies have found liberalisation to be generally associated with a long-term deterioration in growth and industrial development (Roberts 2000: 612-613). Consequently, seeing that the normative theories of trade have been made invalid, the Doha Round is also deadlocked. Is multilateralism through the WTO a much too ambitious endeavour? Jensen and Sandrey (2006: 10) claim that due to the contrasting interests of the WTO members, the countries may only agree to partial trade liberalisation. Instead, Jensen and Sandrey suggest that the Doha Round may succeed in commanding a uniform 30 percent cut in all tariffs across all products and the abolishment of all export subsidies. Even so, such marginal developments in the WTO may not dissuade SACU and China from pursuing a bilateral FTA.

2.6.3 Alternative Models to Institutionalising Trade

The GATT achieved its main objective, which was selective trade liberalisation for its dominant members. Cognisant of its limitations, members of the international community launched the WTO during the Uruguay Round of trade negotiations to succeed after the GATT. Arguably, the GATT was not originally an international agreement; it was a multilateral treaty between contractual and consenting parties to liberalisation (Hoekman & Kostecki 1995: 12). As a result the GATT has been understood by critics to be subservient to its founding members, and not representative of the trade interests of all states. On the other hand, the agreements of the WTO are founded upon mutual obligation and a balanced representation of the interests of all its members, which are to be realised through reciprocal market access commitments.

Certain scholars believe that the collapse of the international trading system during the 1930s was a catalyst for the Second World War. Therefore familiar challenges during the 1940s prompted states to create the GATT in 1947 (Pigman 1999: 195), which then set a precedent for the creation of the WTO in 1995. The much anticipated failure of the WTO to resolve certain issues over the last decade resulted in the collapse of the Doha Round in mid-2006. Despite the continuation of the negotiation in early 2007, differing perspectives to international trade unceasingly collide. The practice of international trade and liberalisation during the period of the GATT and under the contemporary directive of the WTO differ for two main reasons: the profile of the members; and the scope of trade liberalisation.

Membership to the WTO is virtually global, consisting of 153 members of which the majority are developing countries. During this post-Cold War and post-USSR period, democratic principles of governance had become the established norm. Accordingly, developing countries were expected to be vocal during WTO negotiations. Hence, the WTO deliberated at length whether its first Director-General should be from an OECD country or a developing country. However, the varied demographics and economic standings of the WTO members have increasingly resulted in the organisation's lack of coherence (Collier 2006: 1427). Should trade policy promote development, or should it be a neutral reflection of self-interest (national interests)? This is a fundamental question that remains a variable to much ambiguity in trade still to date. It is widely debated that the North only promotes liberal principles of free market capitalism in the South, but maintains protectionist policies for its own economy – hence the agricultural subsidies of the EU states. Carim (2006: 6) proclaims that although developing countries seek greater market access for manufactured products, market liberalisation must reflect different industrial capacities while granting developing countries sufficient flexibility to promote industrial development and national welfare in a sustainable manner. These colliding interests have stalled the WTO's Doha Round of negotiations, thus prompting countries to explore alternative models of institutionalising their trade relations.

Evidently there is much theoretical debate about the clashing interests of developing countries with developed countries when it comes to trade. However, this is not an exclusive dimension of the challenges experienced in the Doha Round. Developing countries also engage with other developing countries. Furthermore, amongst developing countries the countries are again at different levels of development. In the midst of all of the above, the WTO does not appear to be an amicable forum to mediate SACU-China trade relations. Although the WTO is a key component of international trade, its rules and regulations are not exclusive. Also through bilateral and multilateral relations states agree to certain terms of trade, the culmination of which is market liberalisation through an FTA. The theoretical progression from bilateralism to the FTA will be examined in the next chapter of the dissertation. Chapter Three also provides two cases to evaluate the implications of an FTA on the weaker party.

2.7 Conclusion

International trade theory remains a contentious subject. Considering states have different and often contradicting interests, it is only natural that these different states would adopt differing trade strategies. Liberals have confidence in equilibrium, believing that all parties mutually gain from trade. However, economists who have studied the outcome of liberalisation claim that it affects developed countries in a different manner than it does developing countries. Therefore, one should expect developing countries to adopt neo-mercantilist trade policies irrespective of the prevalence of magnificent free-market capitalist ideals in contemporary international relations. Both China and the SACU countries have relatively inexperienced economies, by global standards. Therefore structural theory forewarns that they should be weary of liberalising their markets to developed countries with far more established industries. But what does trade theory prescribe for developing countries in their engaging amongst themselves?

Liberal theory insists that trade is a generator of stability and peace because it forges relations and mutual interdependence. Mercantilists align with realist theories of self-interest and security. They believe that trade is a generator of wealth and power – it is a zero-sum game. Therefore one must restrict imports and promote a surplus producing economy. Using this principle, SACU's consideration to enter an FTA with China suggests that it is more disposed to liberal trade theory than it is to the contending perspectives of Economic Nationalism and Structuralism. Therefore, perhaps political power has played a role in this position?

As a critique of international trade theory, Structuralism disputes the empirical ramifications of the world's pro-capitalist trade system. Note that these are arguments that both Liberalism and Economic Nationalism make no recognition of. Wallerstein's categorisation of the core, semi-periphery and periphery accommodates for comparative analysis of trade relations between countries at varied stages of development. By deduction, SACU (being at the periphery) exports primary commodities to China (at the semi-periphery). Without the necessary state intervention, a potential free market may only cement and perpetuate the existing trade profile between SACU and China.

The Doha Round demonstrates the WTO's incapability to address trade disparities, while incorporating the interests of all its members. Its agenda has predominantly focused on inter-sectoral trade between the developed and the developing countries. However, SACU and China need an alternative means of institutionalising their trade. Accordingly, the free trade agreement could offer both parties a bilateral solution to liberalisation and strengthening their economic relations. Since the impact of such economic reform is questioned, perhaps the experiences of other developing countries that have endured similar circumstances could shed some light on the subject. Hence, in the next chapter, two cases studies are examined.

CHAPTER 3

A STUDY OF FREE TRADE AGREEMENTS: NAFTA AND EU-SA TDCA

3.1 Introduction

International trade relations are either bilateral or multilateral. This chapter explores the concept of trade relations between states, focusing specifically on how they progress to free trade agreements (FTAs). The earliest detection of the term free trade appeared in discussion papers that date to approximately 380 BC. In his book entitled *Republic* the Greek philosopher Plato made reference to the advantages of a division of labour (Irwin 1996: 13). Plato believed it to be impossible to create a city in a region where it would not need to import, hence the rationale for trade. The production of certain goods, which he reasoned was inevitable, would exceed the domestic demand. Therefore excess could be exchanged for imports between individuals, states and regions. As pointed out in the previous chapter, the mercantilist perspective advanced the state's regulation of trade through tariffs, amongst other means, in order to secure certain national interests. Centuries later the notion of free trade was again introduced to economic thought. This was in reaction to 17th and 18th century mercantilist literature (Irwin 1996: 11). Today, free trade agreements have become an increasingly popular form of conducting trade relations. This can be done either between two states, a group of states, or even between an existing group of states and a third party.

This chapter first offers a brief conceptualisation of the notion 'free trade agreement'. The FTAs fall within the liberal streams of trade relations, where trade is viewed in a positive-sum way. Since the subject of this thesis is to forecast the possible implications of a SACU-China FTA, it is necessary to understand how an FTA functions so as to understand why certain critics argue it may be ill-suited for developing countries. FTAs involve the free exchange of goods and/or services across borders. However, they also facilitate the economic integration of sovereign states, whether deliberately or not. As such, a state acknowledges the role played by another state(s) in its economy. Increased trade should generate more foreign earnings, which contribute towards economic grow.

Facilitating trade through a potential SACU-China FTA may thus offer mutual benefits for both parties. However, what role is China to play in the SACU region's economy? To envisage this possible future, the chapter explores the experiences of two developing countries that entered FTAs with more established economies.

The empirical analysis of free trade agreements through the use of two case studies follows the above. The case studies are presented in order to evaluate the dynamics and implications of an FTA between two parties, particularly when one party is considered substantially less developed than the other. The two case studies are as follows:

- The effect of the North American Free Trade Agreement (NAFTA) on Mexico; and
- The effect of the European Union-South Africa Trade, Development and Cooperation Agreement (TDCA) on South Africa.

NAFTA is an important case-study for this thesis because it was the first time that a developing country entered into an FTA with far more advanced markets. As such, reviewing the impact of the FTA on Mexico's industrialisation could highlight certain elements for SACU. For the review of NAFTA, the chapter evaluates studies produced by the Carnegie Endowment for International Peace, the World Bank and those published in leading journals and magazines. The EU-SA TDCA shows how South Africa's FTA with a far more established market affects its economy. For the review of the EU-SA TDCA, this chapter evaluates reports produced by South Africa's Department of Foreign Affairs (DFA), the South African Institute of International Affairs (SAIIA), as well as studies published in leading journals and popular media. The experiences of Mexico and that of South Africa in their respective FTAs will be used in the next chapters to project the implications of a possible FTA between SACU and China on the region's industrialisation and welfare.

As a final point, three key issues for developing countries are examined: the commodity trade trap; protectionism versus a revenue stream; and industrialisation, under the hypocrisy of free trade. Although all FTAs generally exercise the same principles, the outcome thereof differs especially in relation to a country's stage of development. Since the prospects of increased economic relations between SACU and China are certainly eminent, the purpose of this chapter is to provide an analytical framework for a potential SACU-China FTA scenario by highlighting the experiences of others.

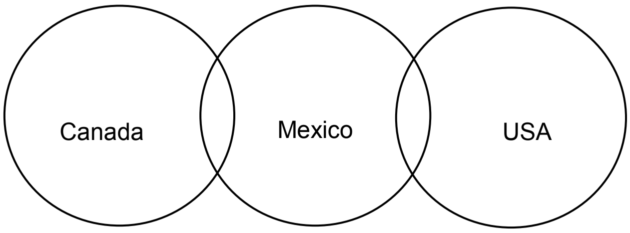
3.2 Free Trade Agreements

The term 'free trade' originated in England at the end of the sixteenth century, during which time it was used in parliamentary debates over foreign trade monopolies. It referred to a commercial activity in which entry was unrestricted. Free trade was a call for 'freedom to trade' in an anti-monopoly movement that opposed government restraints on domestic and foreign trade. During this time, free trade was a means to give merchants the right to trade without official permission or state approval (Irwin 1996: 46).

Gibb (2001: 82) claims that the common denominator of all regional institutions is their intention to establish a preferential intra-regional trade system, if one is not already in place. Ideally, a regional FTA would entail the free movement of the factors of production, all excluding labour. However, in practice the FTA negotiations can amount to varied levels of 'free' or preferential trade terms in relation to sectors and sub-sectors. Furthermore, these are generally executed incrementally over a set period of time (Busch & Milner 1994: 273).

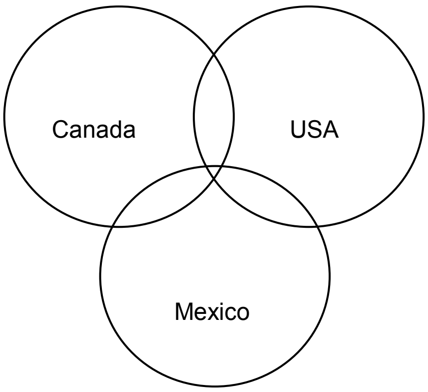
One of the basic constraints of an FTA is its need to ensure that the agreement is not exploited by non-members. Countries engage with varied trade partners in the international system, with which their terms of trade generally differ. To ensure the accurate implementation of trade agreements between states, FTAs make use of the principle of 'rules of origin'. The rules of origin determine which countries can benefit from the tariff concessions agreed upon by the parties to a specific trade agreement. Figure 3.1 indicates that before NAFTA, Mexico engaged in bilateral trade with the USA and Canada, facing trade barriers on both accounts. For instance, all Canadian imports faced trade barriers entering Mexico and would subsequently face more trade barriers when exported to a third party. In this case the third party is the USA, which just happens to have been a party to the Canada-US FTA. Therefore, in terms of the rules of origin, items manufactured in Canada would not be subject to trade barriers when entering the USA through Mexico.

Figure 3.1: Bilateral Use of Rules of Origin before NAFTA



The 'rules of origin' disclaimer distinguishes goods produced by the FTA parties from those produced in the rest of the world. Its purpose is to prevent trade deflection (McQueen 2002: 1376). In Figure 3.2 the trade barriers in NAFTA have been removed. This means that goods produced by the members are traded tax-free and without prejudice - between Canada, Mexico and the USA. However, goods produced in the rest of world (ROW) face trade barriers when entering Canada, Mexico or the USA. For instance, goods entering Canada from the ROW face trade barriers upon entry and should face additional trade barriers if the goods are destined for Mexico or the USA from their initial point of entry in Canada.

Figure 3.2: Multilateral Use of Rules of Origin in NAFTA



With the inertia experienced in the World Trade Organisation's (WTO) Doha Round of negotiations, countries have been prompted to recognise the limitations of multilateralism on a global level. As such, FTAs offer an alternative course of action towards tariff reduction and/or elimination between states, whether in a regional organisation or between consenting parties. There are 153 signatory states to the WTO, of which each is party to at least one regional organisation and perhaps even one or more FTAs (Collier 2006: 1426). The FTAs are negotiated under *Article 24* of the General Agreement on Tariffs and Trade (GATT). This clause allows WTO members to sign preferential trade agreements on the condition that the agreements cover substantially 'all' trade (Andriamananjara & Hillberry 2001: 9). This is to ensure consistency with the WTO's mandate, as the preferential trade agreements may thus set a precedent for homogeneous standards of absolute market liberalisation for all WTO members.

The objective of FTAs is to eliminate trade barriers, but their aim is actually to improve the welfare of participating countries. Monitoring and evaluating their performance, progress and effect are therefore a valuable exercise. The theoretical dichotomy of trade being a zero-sum game was examined in Chapter 2, as part of International Trade Theory. This dynamic is further complicated by the fact that trade occurs between unequal partners – countries with varied economic structures that are also at differing stages of development. Some scholars express concern about the sustainability of reciprocal trade between such unequal partners (Alden & Soko 2005: 378). NAFTA provides the first practical example of both. It is the first reciprocal trade agreement between a developing country and two industrial countries (Cooper 1999: 229). NAFTA also offers a broad enough timeframe to review its impact on Mexico. A study of the EU-SA TDCA is equally important because it involves South Africa, and thus affects the BLNS countries. Through the experiences of Mexico and South Africa, in their respective FTAs, three key issues will be identified for critical consideration. These issues will raise important questions for developing countries about the impact of FTAs on sustainable development, industrialisation and welfare.

The liberal paradigm of international trade has prompted the idea of widening trade relations between countries, which can be performed either bilaterally or multilaterally through organisations (Woolcock 1999: 25). Hence, the concept of trade liberalisation was formed. Orthodox trade theories suggest that liberalisation should stimulate increased exports relative to the size of one's reduced trade barriers. However, analysts have observed a paradox in liberal theory, especially relating to developing countries. Generally, the products (sub-sectors) whose exports shares increase are those that already had relatively low levels of protection (Roberts 2000: 619). Regarding the impact on SACU of mutual SACU-China market liberalisation, this raises two main points of concern:

- Liberalisation may fail to diversify the export profile of SACU, limiting the region's prospective increased volume of exports to its current profile; or

- As the weaker developing region, SACU's focus on liberalisation should not be eclipsed by market access into China, but rather assess the impact of market liberalisation on its regional economy.

These two points present serious implications that invalidate the central rationalisation of FTAs for developing countries. However, the liberal paradigm only offers one of the contending theories to international trade.

3.3 The North American Free Trade Agreement

The USA has long been Mexico's most important trading partner, accounting for over 70 percent of its total trade. The USA is also the source of approximately two thirds of Mexico's FDI. As such, trade economists considered the expansion of the former Canada-US Free Trade Agreement of 1988 as the next standard sequence in solidifying North America's integration. The initial consideration to negotiate an FTA was made in mid-1990. Formal negotiations began the following year in June. By August 1993, NAFTA was officially launched and subsequently implemented on 1 January 1994. The pace of the negotiation process and the swift implementation of NAFTA are both fairly impressive features of contemporary regionalism (Cooper 1999: 229; Love & Lage-Hidalgo 1999: 208).

3.3.1 Overview of the Agreement

The North American Free Trade Agreement is a legally binding contract that provides a comprehensive framework for promoting trade and investment between its member states - Canada, Mexico and the USA. NAFTA is the world's largest single market economy, with a population of 447 million people and an annual value of production of over US$ 14 trillion. The aim of NAFTA is to cut tariffs and liberalise the quantitative restrictions (quotas) on trade. As per *Article 302* of the NAFTA Agreement, the parties would progressively eliminate their customs duties on goods cited in Annex 300-A (the automotive sector) and Annex 300-B (the textile and apparel sector). In broad terms the scope of NAFTA includes agriculture, computers, motor vehicles, and textiles (CIA World Factbook 2007: Internet; NAFTA 1993: Internet). It also protects intellectual property rights and outlines the elimination of investment restrictions among the members. The tariffs between Canada, Mexico and the US were to be gradually removed over a 10-15 year period. The timeframes differ according to commodity and tariff-rate quotas were used as a transition mechanism to eliminate quantitative restrictions. Tariffs were thus incrementally phased out towards free trade (Krueger 2000: 763; Love & Lage-Hidalgo 1999: 208; Yunez-Naude 2002: 8).

The strategic importance of intellectual property[19] to the USA is projected in Part Six of the NAFTA treaty, which is an entire section completely dedicated to outlining the members' legal obligations and responsibility in protecting and enforcing intellectual property. *Article 1071* cites four international treaties[20] that the members were compelled to ratify and integrate into their domestic law (NAFTA 1993: Internet). Since Canada was already familiar with the USA's high regard for IPRs in the former Canada-US FTA, this section was clearly entirely directed at Mexico. What is the relevance of this? Did the USA have any grounds for concern regarding Mexico's regulation of IPRs?

Plagiarism, IPRs violations and the mass production of counterfeit goods have become critical issues in world trade, especially according to the North-South model of international relations that is adamant to preserve existing knowledge structures between developed and developing countries. Of the four global structures of power in the world economy,[21] the knowledge structure is often the most overlooked and underrated structures of power. Strange (1988: 121 & 136) claims that the "knowledge structure determines what knowledge is discovered, how it is stored, and who communicates it by what means, to whom and on what terms." In the contemporary economic setting, knowledge (i.e. advanced technology) has increasingly become a means of establishing economic prosperity and military superiority. Therefore, states are eager to limit the free and/or criminal distribution of such knowledge.

Nonetheless, it is difficult to distinguish between whether the prevalence of counterfeit goods in developing countries is due to a lack of supply (in spite of an obvious growth in

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[19] Intellectual property rights are defined under TRIPs in Chapter 1.

[20] The *Geneva Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of their Phonograms* (Geneva Convention, 1971); the *Berne Convention for Protection of Literacy and Artistic Works* (Berne Convention, 1971); the *Paris Convention for the Protection of Industrial Property* (Paris Convention, 1967); and the *International Convention for the Protection of New Variety of Plants* (UPOV, 1978) (NAFTA 1993: Internet).

[21] Refer to Chapter 2 - section 2.2 International Trade: Distinguishing Between the State and the Market.

demand) or due to a consumer preference for the 'low-priced substitute'. IPR infringements are generally tackled through highly regulated legal provisions. Increased trade and/or FDI may thus assist in combating IPRs violations. Furthermore, the incentives offered in a free trade agreement could facilitate FDI and cooperation. NAFTA encompasses a selection of non-trade features including social issues and foreign direct investment (Cooper 1999: 229). The investment obligations of NAFTA accord national treatment to its investors, thereby eliminating certain performance requirements that were previously demanded of foreign investors. In the process it also opened up certain Mexican sectors, namely the petrochemicals and financial services (Hufbauer & Schott 1993: 3). However, since *Article 27* of the Mexican Constitution prohibits foreign control of 'strategic' industrial sectors, Mexico's foreign investment policy therefore still maintains certain restrictions on inward investment - specifically in the banking, communication, transportation and natural resource extraction industries (Love & Lage-Hidalgo 1999: 209). Although FTAs stimulate increased trade and investment, Mexico's protection of 'strategic' industries demonstrates an element of caution taken against complete market liberalisation. However, is this not contradicting the fundamental purpose of an FTA?

The implementation of NAFTA was not done without contestation. It challenged the domestic welfare of its members on different levels. The more integrated NAFTA became in the economies of the Canada, Mexico and the USA, there also emerged miscellaneous issues. Since it is the intention of this chapter to examine the effect of FTAs on developing countries, the focus herein is on the effect that NAFTA has had on Mexico. However, at the outset the country's widely reported and most recent economic crisis must be contextualised.

3.3.2 The Peso Crisis: 1994 - 1995

Up until 1994, the USA and international financial institutions (IFIs) had considered Mexico to be a model of economic development. Then only one year after NAFTA was implemented, Mexico experienced its worst ever economic regression. Some observers claim that the crisis was a direct result of trade liberalisation. However, the findings of more thorough investigations refute these allegations and rather attribute the crisis to currency appreciation (Lustig 1997: 605). Before assessing the impact of NAFTA on

Mexico, it is therefore only sensible to first separately examine Mexico's Peso Crisis in order to establish a clear relation of causation.

It was unforeseen that during the period in which NAFTA was launched, the Mexican economy would begin to slip. Sceptics almost immediately accused the FTA of instigating Mexico's financial recession, a slump that was basically characterised by an abrupt period of huge capital outflows that started towards the end of 1994 and continued into 1995. (Polaski 2004: 18). Some observers, though, claim NAFTA's role may have been trivial. They attribute Mexico's economic slump to a combination of other factors, namely political shocks, domestic political instability, Mexican policy responses, and the rising US interest rate.

Lustig (1997: 607) identifies three particular events, which she believes generated what she refers to as 'utter market hysteria'. These are the Zapatista guerrilla uprising in Chiapas and the assassinations of the Partido Revolucionario Institucional (PRI) presidential candidate Luis Donaldo Colosio[22] and the PRI Secretary General José Francisco Ruiz Massieu[23] a few months later. These events compromised investor security, which led to a retraction of potential ventures. For instance, after Colosio's assassination in March 1994 and Massieu's assassination in September 1994, Mexico lost approximately US$10 billion (nearly 40 percent) of its international reserves (Lustig 1997: 606 - 607). This was only the beginning of more capital flight and investment insolvency.

The Carnegie report adopts a more economic stance on the Peso Crisis. According to Polaski (2004: 18) Mexico's experience was a result of two main factors – the outcome of its long-term domestic policies and a reaction to a period in which most of the developed world was experiencing economic recession. During the late 1980s Mexico implemented drastic policies aimed at financial liberalisation for greater capital mobility. This was achieved by eliminating controls on capital and foreign exchange. Mexico also pegged its currency, the peso, to the US Dollar on a fixed exchange rate dubbed the

[22] Luis Donaldo Colosio (1950 - 1994), PRI President and the presidential candidate scheduled to have run in Mexico's 1994 general elections, was shot in the head during a campaign rally in front of local media and the press.

[23] José Francisco Ruiz Massieu (1946 - 1994), PRI Secretary General and succeeding presidential candidate, was shot a few months after Colosio's assassination, also in broad daylight.

'crawling parity band'. Shortly after, Mexico began to receive huge capital inflows, especially triggered by a series of privatisations and the rise of the oil prices.[24] The majority of the capital inflow was mostly portfolio investment[25] and not foreign direct investment. It was only briefly in 1994, once NAFTA took effect, that FDI in Mexico exceeded the short-term portfolio investments.[26] When the US Reserve Board perpetually raised interest rates during the course of the year, portfolio investments in Mexico subsequently contracted rapidly. The assassinations of the two PRI presidential candidates only exacerbated circumstances, by lowering investor confidence. In an attempt to service existing debt, the government shifted public debt out of the peso into dollar-based securities, at least until new short-term (three-month) bonds could relief some of the pressure. However, by the end of the year Mexico had exhausted nearly all its reserves. On December 22, 1994, the Bank of Mexico announced that the peso would be allowed to float, on a flexible exchange rate. Within a week the peso depreciated nearly 55 percent; the devaluation continued throughout 1995 (Polaski 2004: 19).

By the third quarter of 1995 Mexico had begun its economic recovery. This was driven mostly by increased exports, those of apparels and textiles, auto and auto parts, food and beverages, agriculture and cattle products. NAFTA's role in this instance was allegedly a catalyst. According to Lustig (1997: 607) although the respective sub-sectors had been fairly integrated prior to 1994, the FTA facilitated the swift pace of Mexico's exports to the USA.

3.3.3 Mexico: The Benefits of NAFTA

Before the launch of NAFTA, the US and Mexican officials both passionately argued about the benefit of expanding the Canada-US FTA. They claimed NAFTA would encourage job creation in Mexico and thus reduce the illegal migration of Mexicans into the USA. Although trade and investment liberalisation were the prime objectives of

24 Mexico has the largest proved oil reserves in North America, exporting over 90% of its production to the USA (Alberro, Castañeda & Gardels 2005: 69).

25 Portfolio capital was invested in government bonds as well as in corporate bonds and stocks. Portfolio investment is more mobile/liquid than FDI, which generally involves establishing fixed operations – building factories, purchasing equipment, etc. FDI is therefore more difficult to liquidate (Polaski 2004: 18).

26 Investments in Mexico's government bonds were generally of a short range, because most of the bonds were issued for a three-month term (Polaski 2004:18).

NAFTA, the World Bank claims that much more was (and perhaps still is) expected from the FTA. The new-found partnership was presumed to fast-track growth, create employment opportunities, and align Mexico's income/wages towards that of its partners (Lederman & Servén 2005: 337; Papademetriou 2004: 39). More than a decade has passed since the launch of NAFTA, and a significant amount of research has been conducted to monitor NAFTA's performance and assess its effect. To justify the validity and purpose of NAFTA, one must review how it has benefitted Mexico.

Regional Trade Policy

Long before Mexico's ratification of NAFTA, the country had already been undergoing extensive macro economic reform. An early detection thereof was in 1986 when Mexico became party to the GATT. Having shifted its policy on protectionism, from quotas to tariffs, thereafter Mexico gradually reduced its trade barriers within North America. By the time Mexico joined NAFTA, its reform process had already been underway. Once NAFTA was officially launched, Mexico began to experience reciprocal trade liberalisation in North America. Mexico now has increased and preferential access to the USA market (Hufbauer & Schott 1993: 5; Sanchez-Reaza & Rodriguez-Pose 2002: 73).

Upon the ratification of NAFTA, Mexico adopted a firm export-driven economic policy to boost its manufacturing capacity. The policy concentrated on increasing its production of automobiles, motor engines and auto parts, computers and other electronic equipment. From 1994 to 2003, these products accounted for nearly 58 percent of Mexico's exports (Moreno-Brid, Santamaria & Valdivia 2005: 1107).

Increased Trade and Investment

Mexico's membership of NAFTA has had a direct impact on intra-NAFTA trade, generating an increase in the quantity of cross-boarder trade. The World Bank claims that NAFTA merely reinforced existing North American trends in trade growth, especially between Mexico and the USA (Hornbeck 2004: 2). Overall, there has certainly been an increase in trade. However, what is the significance of this increase? Has the increased trade with the USA been at the expense of trade with the rest of the world? A key concern of trade analysts is that FTAs compromise multilateralism and the efforts of the World Trade Organisation (WTO) by triggering trade diversion – less trade with the rest of the world, and more trade between members. Developing countries must recognise that trade diversion does not necessarily generate increased income, as it is merely a reflection of a preferential treatment given to certain import partners.

Mexico's imports in 2007 amounted to US$ 283 billion, of which 50 percent of the total imports were sourced from the USA. During the same year Mexico's exports amounted to US$ 271 billion, of which 84 percent of the total exports went to the USA (CIA World Factbook 2008g: Internet). The World Bank has found no evidence of Mexican trade diversion in NAFTA (Hornbeck 2004: 3). This means that instead of trade diversion, NAFTA has actually been instrumental in Mexican trade creation. Furthermore, NAFTA has boosted the country's economic profile in international trade.

The World Bank estimates that Mexico's global exports would have been 25 percent lower without NAFTA (Hornbeck 2004: 2). Trade liberalisation in Mexico reduced certain risks and increased Mexico's attractiveness as a destination for FDI. By increasing trade and regional integration, NAFTA has also helped Mexico to attract FDI and achieve economic diversification – a dynamic industrial and service sector (Sanchez-Reaza & Rodriguez-Pose 2002: 76).

NAFTA was instrumental in directing FDI into Mexico. The World Bank noted that it led to a 40 percent increase in Mexico's annual FDI, without diverting it from other countries (Horbeck 2004: 3). Between 1994 and 2002 the USA's FDI in Mexico rose from US$ 16.1 billion to US$ 58.1 billion. Mexican FDI in the USA also increased during the same period – from US$ 2.3 billion to US$ 7.9 billion (Hornbeck 2004: 3).

The Mexican Household's Consumer Advantage

Trade reform has macroeconomic linkages, which makes it an inherent variable of income and poverty. Consumption, a factor dependent on income, is the most common indicator used to measure standards of living. By examining changes in Mexico's consumption, one should thus be able to determine what the effect of NAFTA has been on the country's standard of living. Although Mexico is member of the Organisation for Economic Cooperation and Development (OECD), its domestic socio-economic indicators are weak. This middle-income country is also known for its widespread poverty and large income gap, across rural and urban areas of the country. A World Bank household survey revealed that the poorest 20 percent of the population receive less than 5 percent of the country's total income. In contrast, the richest 10 percent receive nearly 40 percent of the total income. (Ianchovicina, Nicita & Soloaga[27] 2002: 966). It is beyond the scope of this thesis to examine the cause of Mexico's poverty; as it would be difficult to extrapolate NAFTA's role in this regard. However, NAFTA did amplify competition in the market place.

Competition in a free market capitalist environment generally places the consumer in an advantageous position. It generates more variety of product and/or service at lower prices. Accordingly, NAFTA has had a direct impact on the consumer buying power of Mexico's poor households. The World Bank claims that the poor households in Mexico spend half of their total income on food products. Due to NAFTA's tariff reduction, Mexico's poor households now have access to cheaper food (Ianchovicina et al. 2002: 966). The real domestic prices of all basic crops have decreased under NAFTA, when comparing prices of between 1994 to 2000 to former prices between 1991 and 1993 (Yunez-Naude 2002: 15). Although Mexico's households may have a consumer advantage due to NAFTA, the widening income gap remains an issue. New investments are being redirected towards Mexico City, away from the US border, to shift the zones of maquiladora employment (Sanchez-Reaza & Rodriguez-Pose 2002: 86). However, the income gap is still widening, between the rich and the poor as well as between the prosperous and lagging regions of the country. This is only one of several issues that have been raised against NAFTA. Now that Mexico's main benefits have been examined, it is opportune to review NAFTA's critics and the criticism it has received regarding its impact on Mexico.

3.3.4 NAFTA Critics and the Criticism

Analysts assumed that once Mexican consumers became more familiar with new imports from trade liberalisation, the purchases of imported goods would gradually lose momentum. However, certain critics claim that NAFTA has only reinforced unevenness in North American interdependence. They claim that Mexico is thus sublimely trapped in an asymmetrical relationship. Although it may win some concessions, it risks losing

[27] Elena Ianchovicina is an economist at the World Bank Economic Policy Unit; Alessandro Nicita is a trade analyst at the World Bank Trade Unit; and Isidro Soloaga is a professor at the Universidad de las Americas-Puebla in Mexico.

much more from the disintegrating global rules. By signing into NAFTA, Mexico has forfeited its right to WTO provisions against trade dumping for all cases that could have been brought up against the USA and/or Canada. For this reason it is vitally important that Mexico diversifies its trading partners (Cooper 1999: 231). By seeking additional trade partners, Mexico will reduce its dependence on the USA and render it less susceptible to financial shocks experienced in the US economy.

Figure 3.3: Key Economic Indicators in NAFTA (2007)

NAFTA Countries	GDP - US$ Trillion	GDP per Capita – US$	GDP Growth Rate
Canada	1.266	38,400	2.7%
Mexico	1.346	12,800	3.3%
USA	13.840	45,800	2.2%

Source: CIA World Factbook (2008g: Internet)

The income disparity between the USA and Mexico has always been fairly large, indicative of the typical economic contrast between developed and developing nations. However, GDP figures reveal that this gap has been gradually decreasing over the last decade. During the mid-1990s the USA's economy was nearly 25 times that of Mexico's. By 1997 it was then 20 times larger.[28] Ten years later in 2007, as displayed in Figure 3.3, the USA's economy is now only 10 times larger than Mexico's (Lustig 1997: 608). In essence, it appears that NAFTA may have stimulated economic convergence between its members, and even to the extent that Mexico's economy is now outperforming Canada's. However, economic growth is not an accurate reflection of income distribution or of an improved quality of life.

Economic growth is also not necessarily an accurate indicator of sustainable development and industrialisation. By deduction, it appears that NAFTA may have had a more visible effect on Mexico's macro economy in comparison to the USA and Canada. However, what has been the impact of NAFTA on Mexico's micro economy and its domestic indicators? How has NAFTA affected the businesses in Mexico and its industrialisation process?

[28] In 1997 the USA's gross domestic product was US$ 8,250 trillion and Mexico's was US$ 401,480 billion. During the same year, Canada's GDP was US$ 627.602 billion (Nation Master 2007: Internet).

Industrialisation: domestic and foreign investors compete for market share

A major difficulty that Mexico (like most developing countries) has to deal with is how to incorporate large sectors of the population into the dynamics of industrialisation and modernisation (Alba-Vega 1998: 162). The USA has a key role in Mexico's economy – as a trade partner, an investor, as well as a contributor to industrialisation. Back in 1965, under the Border Industrialisation Program, Mexico and the USA launched the maquiladora (production sharing) programme. As part of the maquiladora programme Mexico was allowed to import input products (components) on a tariff-free and tax-free basis for assembly/manufacturing, and then re-export the finished products to the USA (Truett & Truett 2007: 374). To kick-start the programme, the Mexican government and several US companies took the initiative to set up maquiladoras close to the US border. However, the launch of NAFTA changed the pace of FDI into Mexico and put the country's maquiladora sector in a compromising position.

Trade analysts claim that NAFTA has exacerbated uneven growth and industrialisation in Mexico. Granted, Mexico's maquiladora programmes had already drawn US investments to the Northern parts of the country; but when NAFTA came into effect the FDI followed suit and predominantly entered Mexican cities that were also closer to the US border. More recent investors placed their businesses in direct competition with the established maquiladoras. Furthermore, NAFTA stripped the maquiladora sector of fundamental privileges that enabled its operation. *Article 303* of NAFTA restricts duty-free imports into Mexico from countries that do not meet NAFTA rules of origin, which cite that 50 percent or more of the content must be produced within the free trade area. The studies that have been conducted assessing NAFTA's effect on the maquiladora sector focus either on employment or on value-add. The research of NAFTA's effect on employment is unconvincing at this stage. However, NAFTA's effect on value-add is a matter of concern. Before NAFTA, Mexico's input products sourced from Japan and Singapore duty-free could enter the USA after processing, with duty only being assessed on the value of the finished product. However, with the new rules of origin, the maquiladoras are compelled to source more input products within the free trade area, which has only reduced their products' competitiveness (Truett & Truett 2007: 375 - 376). By diluting the maquiladora's competitive advantage, NAFTA has indirectly weakened its value-add. As a result, Mexico's 'free market' has increasingly become more lucrative for the recent investors.

It is the intention of market liberalisation to give equal opportunity and treatment to both domestic as well as foreign investors. However, has Mexico's policy reform been reciprocated? The maquiladora sector is open to US competition. Can the same be said of the US market being open to Mexican competition? Quite the opposite, the USA placed stringent provisions in NAFTA to protect its most competitive export products. In the pharmaceutical industry, for instance, NAFTA's IPRs policies offer no prospect for technology transfer (Cooper 1999: 237). Mexico's experience in this regard and its effort to stay poised amidst contending investors should be viewed as a lesson for developing countries, especially for those that intend to negotiate FTAs with developed countries.

The labour force and employment

Employment is generally the main source of household income. Therefore one of the criteria used to assess the impact of an FTA on an economy is to measure its effect on the well-being of people through job creation or job loss. Mexico has an abundant labour force that grew from 32.3 million shortly before NAFTA to 44.71 million in 2007. This means that Mexico has needed to produce an average of one million jobs per year in order to absorb its growing labour force. The task appears trivial for a country where the unemployment rate is 3.7 percent, but Mexico also has an underemployment rate of nearly 25 percent (CIA World Factbook Internet: 2008; Polaski 2004: 11). This suggests that a large portion of the population may be active in the informal sector, which is difficult to measure and even more difficult to incorporate into the formal economic system. NAFTA's involvement herein is highly scrutinised, as is the contentious role of the USA.

New employment in developing countries is generally created through industrialisation. As such, the maquiladora programme's contribution, in this regard, has been recognised. The programme became increasingly popular over the years. It has grown from providing nearly 76,000 employees in 1974 to almost 1.3 million employees in 2000 (Truett & Truett 2007:374). However, the maquiladora initiatives do not necessarily offer lucrative employment. The wages were generally lower than the national average and the factories are allegedly situated in hazardous occupational environments (Cooper 1999: 237). According the Carnegie report, the non-maquiladora sector's employment figures have fluctuated abrasively since 1994. It employed fewer workers in 2003 than it did in 1994 - 1.4 million and 1.3 million respectively (Polaski 2004: 15). This only indicates that Mexico's non-maquiladoras manufacturing labour force has shrunk over the years. Could this have been a result of market liberalisation and the subsequent inflow of FDI? About 100,000 jobs were lost in the non-maquiladora sector. For a country that was meant to create over 1 million new jobs per year, what has been the effect of market liberalisation on the other sectors of Mexico's labour force?

Through NAFTA, Mexico reduced its tariffs on agricultural and livestock products, as well as on most manufactured goods. Although the USA opened its market to Mexican exports, it maintained certain strategic tariff and non-tariff barriers. For instance, the USA may have reduced its agricultural tariffs but it simply increased its quotas. The Carnegie report claims that this is why one of Mexico's main agricultural export products, sugar, still faces trade barriers when entering the USA (Polaski 2004: 14). The liberalisation of Mexico's agricultural sector has been tough on the country's labour force. Trade economists had foreseen that NAFTA would result in increased agricultural imports in Mexico. Almost instantaneously the domestic producers faced stiff competition from US suppliers, which caused product prices to fall because of the US export subsidies. Ideally, the deregulation of the agricultural sector should have prompted Mexico to improve its allocation of resources, which would in turn improve its efficiency and hike its productivity. However, the reality of liberalising the agricultural sector has been bleak (Yunez-Naude 2002: 11). As the agricultural trade deficit with the USA increased, Mexico's agricultural labour force suffered. Therefore more Mexican workers, who had previously contributed to Mexico's formal economy, were made redundant.

Apart from creating new employment generating initiatives, Mexico has also had to reintegrate retrenched workers back into the economy. Since the workers were generally semi-skilled, they could only be channelled into the manufacturing sector – the maquiladora manufacturing sector. In 2003 the maquiladora sector employed approximately 550,000 more workers than it did before NAFTA, but even it could not absorb the demand. In spite of data limitations, censuses studied by Carnegie reveal that the jobs created in the manufacturing sector did not meet the levels of jobs lost in the agricultural sector (Polaski 2004: 12). Mexico's experience demonstrates market liberalisation can create irreconcilable conditions for a developing country's labour force.

3.4 The EU-SA Trade, Development and Cooperation Agreement

The EU's relationship with African countries (its former colonies) has generally been guided by multilateral treaties between itself and countries from the African, Caribbean and Pacific (ACP) region - signatories to the Lomé Convention of 1975.[29] The Lomé Agreement was a preferential trade and aid agreement between the EU and the ACP countries, which did not compel the ACP countries to reciprocal trade concessions. South Africa's initial application to join the Lomé Convention during the early 1990s was denied on the grounds that its economy was too strong for a non-reciprocal trade agreement.[30] The EU regarded SA as a middle income country and not as a developing country like the remaining ACP countries.

After renewed negotiations, the EU allowed SA to join the Lomé Convention in 1997, but under restricted terms. SA's special status excluded it from general trade arrangements, trade protocols, and financial assistance provided by the European Development Fund (EDF). However, this arrangement offered minimal benefits to the South African economy, whose exporters sought greater access to the EU market. Since the Lomé Convention was due to expire in February 2000,[31] the EU thus proposed that both parties negotiate terms for a bilateral trade agreement (Craven & Mather 2001: 313; Joubert & Smit 2002: Internet).

In October 1999, South Africa and the EU[32] signed the Trade, Development and Cooperation Agreement (TDCA). It is also supplemented by four additional agreements:

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[29] The EU's relations with the ACP countries has evolved from colonial associate status (Associated African States and Madagascar), to independent Associated States, to partners under the Lomé Convention, then partners under the Cotonou Agreement and now partners under the Economic Partnership Agreements (EPAs).

[30] Following years of sanctions, South Africa returned to the global arena after its historic first democratic elections of 1994, which effected the country's emancipation from the apartheid system.

[31] The Lomé Convention was terminated in 2000 due to poor management and lack of service delivery. It was subsequently replaced by the Cotonou Agreement. One of the major differences between the two agreements was that the new partnership under the Cotonou Agreement incorporated new actors - including civil society, local authorities, the private sector and trade unions amongst others.

[32] The EU's membership consisted of 15 states during the signing of the TDCA: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom. An additional 12 have since then become EU members: Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia (EUROPA 2008: Internet).

the Cotonou Agreement (the former Lomé Convention); the Fisheries Agreement; the Science and Technology Agreement of 1996; and the Wine and Spirits Agreement of 1999 (Links 2000: 33; Joubert & Smit 2002: Internet). The TDCA is the first official phase of an economic partnership that both parties intend to develop into an FTA by 2012 (DFA 2008: Internet). The South Africa-European Union Free Trade Area (SEFTA) will, however, only be WTO compatible once duties have been eliminated on more than 90 percent of all trade between both parties (Gibb 2001: 78). If congruence with the WTO is an end-goal, what parameters have been set to lead the way?

The first EU Ambassador to South Africa, Erwan Fouéré, announced that the following principles were the beacons of the EU's foreign policy towards South Africa:

- Respect for human rights and democratic principles;
- Support for balanced and sustainable social and economic development and cooperation;
- Freeing up trade by encouraging investment by European companies in South Africa and vice versa (Venter & Neuland 2004:187).

Guided by the above, the EU and South Africa are now signatories to a bilateral free trade agreement. The first segment of SEFTA, referred to as the TDCA, is an interesting case study that is relevant in this chapter for two important reasons. Firstly, like NAFTA the TDCA is a bilateral agreement between a very strong market economy and a developing country. Furthermore, data to be provided below will demonstrate that South Africa is far more dependent on the EU as a trade partner than vice-versa. Secondly, the TDCA involves South Africa, which is a key player in the SACU region's geopolitics and economy. South Africa's experience in the TDCA negotiations and the impact thereof thus offer tremendous insight for a comparative analysis of the possible implications of the SACU-China FTA on the region's business and industrialisation.

3.4.1 Overview of the Agreement

The TDCA regulates the trade relations, development cooperation and financial aid as well as other fields such as political dialogue and socio-cultural cooperation between the EU and SA. The agreement contains two main parts. The first part specifies the products from which the tariffs will be removed immediately as of the contracted date of implementation – January 1, 2000. The second part of the agreement details the phased elimination of tariffs on the remaining product categories - i.e. agricultural, fisheries, and industrial products[33] (Akinkgube 2000a: 640).

The TDCA is based on rules of origin, which permits only products that originate or are considered to originate from the EU or SA to benefit from the agreement. *Article 28* of the TDCA states that "[t]he rules of origin for the application of tariff preferences provided for in this Agreement are laid down in Protocol 1". Accordingly, all conceivable products are tabled in lists that contain specific rules of origin, tariff numbers and benefits under the agreement. Furthermore, cumulation is an alternative method for a product to attain EU or SA 'origin' in order to qualify for benefits under the agreement. It allows goods produced in one country to be treated as if they were produced in another country, especially considering the prevalent use of imported input products for manufacturing. However, bilateral cumulation between the EU and SA, which is mandatory of the TDCA, does not offer the same opportunities for both parties. It grants the EU's hi-tech industries better access to SA's market for sourcing raw material and supplying competitive consumer products. However, can the same be said about the sourcing of input products used by SA's manufacturing industry? Instead, the TDCA provides for cumulation with the ACP countries. All materials originating from the ACP countries are to be considered as originating from the EU or SA, when incorporated into a product that has undergone sufficient processing in the EU or SA. The 'sufficiency' is determined by whether that value added, either in the EU or SA, exceeds the value of materials used originating from any one of the ACP countries (European Commission 1999: 40; Joubert & Smit 2002: Internet).

For South African exports to the European Union, tariff reductions were to take place over a period of 10 years for 61.4 percent of agricultural exports, and 99.98 percent of industrial exports. However, within three years of signing the agreement 97 percent of non-agricultural exports were to enter the EU duty-free. South Africa has also been

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[33] The items are specified in lists 1 to 5 of industrial products - annex II of the agreement, lists 1 to 8 of agricultural products - annex IV of the agreement, and list 1 of fisheries products - annex VII (Akinkgube 2000b: 97).

allowed to export 60,000 tonnes of canned fruit at favourable rates, and 32 million litres of South African wine at 50 percent rebates to the most -favoured nation (MFN) rate. Over a period of 5 to 20 years South Africa is to gradually phase out the labels ‘Port’ and ‘Sherry’ from its wines. In return the EU agreed to offer South Africa €50 million worth of financial assistance to improve South Africa’s wine sector. As for the EU’s exports, SA agreed to reduce its tariffs over a period of 12 years for 86 percent of trade (Akinkgube 2000a: 642; Akinkgube 2000b: 97).

One of the EU’s most uncompromising arguments during the four-year negotiations of SEFTA was the use of names, which specialists in the domain refer to as intellectual property. Discrepancies over the use of the names ‘port’ and ‘sherry’ amongst several other wines and spirits continually stalled the FTA negotiations (Craven & Mather 2001: 312). South African negotiators eventually succumbed, forcing local manufacturers to rename and rebrand their product line. The change was implemented in the domestic market as well as for all exports. This case was demonstrative of the extent to which the EU’s non-tariff barriers restrict trade. It demanded the renaming and relabeling of consumer products, which also had to meet certain environmental and sanitary standards of approval.

3.4.2 Defining the EU – SA Trade Profile

The nature of trade between South Africa and the EU is a necessary subject to discuss for two reasons. First, the topic begs ones to study the shape of the South African economy and what it has to gain from the EU. Second, an overview of the trade trends is a prerequisite for assessing the impact of the TDCA. The ratification of the TDCA was considered to be a natural step forward in formalising South Africa’s pre-existing trade relations with the members of the European Union (Venter & Neuland 2004:188). Since the South African economy was a variable used to justify the need for a separate trade agreement from the remaining ACP countries, then one must review whether EU-SA trade has had any effect on South Africa’s economy since the launch of the TDCA.

The EU is one of South Africa’s major trade partners, supplying nearly a quarter of South Africa’s imports and purchasing almost just as much exports – 36 percent and 34.5 percent respectively in 2006 (DTI 2007b: Internet). During the first five years after the signing of the TDCA, trade between the EU and SA rose by nearly 50 percent, just over ZAR 200 billion.[34] This figure rose again to ZAR 313 billion in 2007 (DFA 2008: Internet). Note that in 1994, trade between the two parties only amounted to ZAR 56.5 billion. However, despite the increasing amount of trade that both parties continue to experience, displayed in Figure 3.4, South Africa is a far less important trading partner to the EU than vice-versa. Only 1.3 percent of the EU's total imports are from South Africa and the EU exports only 1.8 percent of its production to SA (Lemon 2000: 454). Trade has clearly increased since the signing of the TDCA, but what is the significance of this?

Figure 3.4: Outlook of EU-SA Trade from 2004 until 2007

Source: Department of Foreign Affairs (2008: Internet)

The relationship between economic growth and the redistribution of wealth is disputed. As such, social scientists refer to unequal growth, voiceless growth, meaningless growth, and even futureless growth. According to South Africa's Department of Environmental Affairs and Tourism (2005: 13), with regards to the SACU region, one may need to conjure up the term 'jobless growth'. At the outset, one must thus also recognise that such an asymmetrical trade profile can only further exaggerate the negative impression of South Africa's trade deficit with the EU. South Africa's trivial share of the EU market suggests that it may actually be a dispensable trading partner of the EU and could thus

[34] In 2005 SA's exports to the EU amounted to ZAR 116.7 billion, while imports amounted to ZAR 93.36 billion (Ntingi 2004:5). The total EU-SA trade in 2005 thus amounted to ZAR 210.06 billion.

be easily substituted. EU exports to SA are generally manufactured goods, especially in the automotive sector, and fast moving consumer goods. SA's exports to the EU are mostly low-cost primary commodities and 'uncompetitive' agricultural goods.[35] Yet, so much of South Africa's foreign revenue is dependent on the EU. On a micro-economic scale, this may be a legacy of SA's history with members of the EU. After all, South Africa has a recognised cultural heritage from Western Europe, which includes music, language, food and business. South Africans speak English, Dutch, French, German, Greek, Portuguese and Italian (Lemon 2000: 451). However, on a macro-scale, if the TDCA cemented (and continues to perpetuate) uneven trade relations between the EU and SA, what are its implications on South Africa's socio-economy, the private sector, regional geo-politics and sustainable development?

3.4.3 The Effect of the TDCA on South Africa

A literature review of SEFTA discloses interesting observations. Although there is much debate in the print media (i.e. magazines and newspapers) over the implications of the TDCA on South Africa, there are very few academic papers and journal articles within the discipline on the subject. Even almost a decade into the agreement, there is little research and academic studies that concentrate on what impact SEFTA has and could potentially have on the region – namely SACU and the Southern African Development Community (SADC). This apparent lack of research could be indicative of either indifference, negligence, or a lack of expertise to conduct the critical analysis. However, since the BLNS countries are equivocally party to the TDCA, due consideration is granted to its impact on the SACU region.

Solidifying terms of trade and diplomatic relations with SA's main trading partners

Complimentary of the WTO's mission, the TDCA is an intermediary system that enables reciprocal and incremental trade liberalisation between the EU and SA. The treaty is a legal framework that regulates the terms of business and trade between the two parties. The EU is SA's largest trade partner, but also the world's largest trade bloc. A preferential trade agreement with the EU is thus of enormous political significance to South Africa, because the EU has a prominent role in the international community

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[35] The EU's subsidising of its agricultural products makes the market highly competitive for SA exporters.

(Links 2000: 36). It demonstrates diplomatic solidarity, which can be lobbied for status as well as for support on a number of transnational issues in international forums. The TDCA also represents a shared philosophy on economic development, one that encourages free market capitalism and restricting the role of the public sector.

For the EU, the TDCA has solidified its dominant position and relations (investment, political and trade) with SA above the USA and Japan (Lee 2002: 81). The TDCA also displays the EU's commitment to South Africa as well as the ACP countries, especially since the agreement will allegedly be used as a model for the EU's post-Lomé / Cotonou deals with the ACP countries.

Market access: the growth prospects for SA exports

If the TDCA was implemented to reciprocally improve market access, then surely the choice is two-fold: the TDCA could either have had a positive impact or a negative impact on South Africa – its exports and businesses in the domestic market. Accordingly, the TDCA may even have a positive impact on one particular sub-sector, yet still negatively impact another. However, several analysts remain neutral on the subject and claim that the TDCA may initially have no impact at all. After all, much of the EU's exports to South Africa already entered duty-free, including electrical equipment, machinery and chemicals (Lemon: 2000: 455). This is mostly due to the uncompetitive local production's inability to meet market demands. Nonetheless, in spite of this one must bear in mind that since a fundamental purpose of the FTA is to encourage 'development' through trade and cooperation, then an impression should be made on South Africa's development. For this reason, Lemon (2000: 455) believes that from an export-driven development perspective, South African manufacturers may just be the greatest beneficiaries to SEFTA. But how accurate is this statement? And to what extent will SA exports benefit from market access?

The TDCA's prescribed tariff changes in the EU affect only 25 percent of the current goods that SA exports to the EU. Also, the average tariff of these goods weighed only 2.7 percent (Grant 2006: 3). A few studies have been conducted using a multi-country computable general equilibrium (CGE) model to quantify SA's growth prospects and potential benefits from the TDCA. Some analysts have found that the TDCA will have a negligible impact on SA's economic growth, claiming it will increase the GDP by only

0.44 percent (Lee 2002: 92). However, is this statement still valid bearing in mind the recent expansion of the EU's membership? Even so, could the statement suggest that the increased trade between the EU and SA that displayed in Figure 3.4 may be a result of trade diversion - that was prompted by the TDCA - and not trade creation?

The TDCA has irrefutably opened the EU's market to South African exporters. However, considering the EU's notorious use of domestic subsidies, even South Africa's major corporations are still struggling to compete. South African exporters have little incentive to export to the EU, in spite of the trade concessions. James Lennox, the then chief executive of the South African Chamber of Business (Sacob), was quoted in the *Star* newspaper (5 November 2004: 5) claiming that SA's small, micro and medium-sized enterprises (SMMEs) are risk-adverse with regards to developing a dedicated export industry. Instead, they are predisposed to supply into the domestic market, and then only export residual stock within the SACU or SADC region (Ntingi 2004: 5). Non-tariff barriers can therefore be as much of an obstruction. Considering how uncompetitive the EU market is, how beneficial is the TDCA for South African exporters?

Defensive liberalisation: an aborted mission

After the 1994 elections SA first adopted a social and welfare oriented policy framework, known as the Reconstruction and Development Programme (RDP). The RDP encouraged state intervention in order to redistribute the country's wealth by providing basic amenities, jobs, housing and land to the impoverished citizens. The programme was subsequently supplemented with the Growth, Employment, and Redistribution (GEAR) strategy of 1996 that concentrated on forging stable macroeconomic conditions. SA's economic policy reform entailed reconciling its import-substitution growth strategy with market liberalisation of FDI, trade and increased capital flows, which the state viewed as catalysts to economic growth (Lee 2002: 83). As such, SA sought to improve the terms of trade with its largest trade partner – the EU. The EU welcomed SA's re-integration into the international community and pledged its support of the country's recovery. However, in view of the EU's initial denial of SA to join the Lomé Convention, critics have questioned the sincerity of the EU's commitment to South Africa's development. To what extent is the trade liberalisation reciprocal? What is the significance of the agreed terms?

The TDCA's prescribed tariff changes for South Africa affect 40 percent of the current goods that the EU exports to SA and their average tariff weighed nearly 10 percent (Grant 2006: 3). Compared to SA's tariff concession, it appears that the EU has had to make less tariff adjustments and very little to sectors that are most relevant to diversifying SA's export profile. Furthermore, SACU has forfeited an estimated 21 percent of its total tariff revenue, previously collected from the EU. As a result, Botswana has lost nearly 10 percent of it total national income due to the TDCA. Although the data from Lesotho and Swaziland are not liberally distributed, by deduction the TDCA's impact on their national income must be more severe. In addition, due to TDCA rules of origin the BLNS countries still face trade barriers in spite of SA's preferential access to the EU market (Grant 2006: 4). The TDCA has essentially caused the BLNS countries to lose income and also preferential market access. The TDCA's impact on South Africa's fellow SACU members is of much significance because it indirectly affects SA's diplomatic profile within the region. The repercussions thereof may also compromise SA's position on matters concerning the region's development and its integration. These issues raise the question of whether SA should have negotiated for an indemnity in the TDCA. Although the agreement does contain safeguard clauses for SA, these may only be deployed in the event of trade displacements caused by an influx of EU products (Links 2000:36). Where does this leave SACU and its targets to consolidate a regional trade policy?

Compromising SA's position on the region's development and integration

SACU is an active customs union. SEFTA has thus placed enormous strain on the region's integration, by forcing the BLNS countries into making one of two equally difficult decisions. The BLNS countries would either have had to allow SA's duty-free European imports to enter their porous markets duty-free, or they would have needed to establish customs posts for SA's exports to the BLNS markets to tax the intra-SACU movement of European goods. The former would have meant a loss of customs revenue, which would have been forfeited regardless if SACU had been the initial signatory to the agreement. On the other hand the latter would have undermined the very essence of a customs union, which entails the free movement of goods across the members' national borders. However, in reality all of the EU's duty-free exports to SA would have penetrated the BLNS markets. Therefore, although the TDCA is a bilateral agreement between the EU and SA, the BLNS countries are by default *de facto* parties to SEFTA irrespective of their exclusion from the negotiations (Gibb 2000: 457 & 475). In contemporary international relations, and especially in the post-apartheid era, SA's diplomacy in this instance raises several questions about its foreign policy towards the region.

SEFTA is claimed to be the most successful FTA between the EU and a developing country, as it is the most wide-ranging trade agreement that covers all sectors of the economy including agriculture (Lemon 2000: 456). Yet even the multi-country computable general equilibrium (CGE) models produce unclear and sometimes very opposing results. Lee (2002), for instance, notes that the TDCA will have both positive and negative consequences on South Africa. In any case, is this not a trade-off to be expected of all FTAs? Nonetheless, even assessing the impact of an FTA can be difficult because of technical difficulties experienced in quantifying specific trends and establishing accurate links of causation. Therefore, although it would be imprudent to praise the TDCA's benefits without distinguishing its exact outcomes, one must recognise the challenges of discriminating the effects of an FTA from other interfering variables.

3.5 Three Key Issues for Developing Countries

The impact of market liberalisation is different in developing countries than it is in the established and developed economies. At the outset, the socio-economic indicators of developing countries are generally characterised by a low average GDP per capita income, a low life expectancy, high rates of illiteracy, high rates of population growth, and a high proportion of the labour force in the agricultural sector (Salvatore 1987: 266). These are all socio-economic issues that social scientists claim demand a significant level of state intervention/regulation - i.e. affirmative action, training, and welfare. However, in a free market the role of the state is diluted, and is substituted by the 'invisible hand' of capitalism. Since the state had previously been unable to resolve the issues, then it is presumed that perhaps an FTA will facilitate the process. Unfortunately, there are certain inferences in this rationalisation that juxtaposes the West's prescribed development model (market liberalisation) against the West's experiences of the development process (protectionism). As such, three key issues for developing countries are examined to forewarn developing countries of risks entering an FTA with much more developed markets.

3.5.1 The Commodity Trade Trap

Developing countries, much lacking in significant industrial capacity, have immemorially exported natural commodities and mineral resources. African states, in particular, were founded during the colonial era on this premise. A much disputed legacy thereof, is an alleged 'commodity trade trap'. The existing trade profiles of many post-independent African states continue to reflect a bias towards commodity exports to developed markets. During the 1990s Coote (1992: 28) noticed a decline in the developing countries' exports to developed countries. In 1970 nearly 72 percent of the developing countries' exports went to developed countries. This figure dropped to almost 60 percent by 1990: the EU sourced 23 percent; Japan sourced 12 percent; and the USA sourced 25 percent. This decline of exports to developed countries could be the result of two things, either there has been a drop in demand for the developing countries' exports, or the developing countries have found alternative trade partners.

Both explanations suggest that developed countries may be less reliant on developing countries for natural commodities. Also, bearing in mind foreign policy amendments of the respective parties between 1970 and 1990 one may also consider that the reduction may be a direct result of increased South-South relations. However, the recent growing demand for minerals used in the technology-intensive sector, in addition to Asia's accelerated industrialisation have caused a boom in world commodity prices.[36] There has thus been a steady increase in the volume of African exports, in particular, to developed markets. Yet, in spite of the fluctuating quantity of exports, the quality thereof remains unchanged. For instance, one of South Africa's main industrial activities is motor-assembly of European-brand cars. South Africa thus has the benefit of not having to import European cars, since they are assembled domestically. However, the motor parts and spares are mostly sourced from the EU, whose input products are exported from South Africa (amongst other African countries) in raw format. According to its current trade profile, South Africa is thus exporting raw material and importing semi-processed

[36] The global economic crisis that started in late 2008 has impacted negatively on the commodity boom. Even so, this study deals with these issues in more general terms.

goods. Ideally, the spare parts should be manufactured in South Africa. Yet, how does one cultivate a domestic manufacturing and processing industry under liberal terms of an FTA? These are issues that confront and challenge the industrialisation efforts of developing countries. Draper (2003: 3) claims that developing countries continue to export natural commodities to developed markets, and import advanced manufactured/finished products from the developed world. This trend has even recently sparked debate over a second 'scramble' for Africa (Corbet 2008: 2). With the added factors of market competition under a free trade system, this poses a socio-economic dilemma for developing countries.

An over-reliance on commodity trade is very likely to cause socio-economic shocks, because economic growth is dependent on industrial production. Herewith is a practical example: the manufacturing of European motor-vehicles. Hypothetically, what if BMW, FIAT, and VW amongst others were to make a scientific breakthrough in their use of chemical elements in the manufacturing of motor components? Accordingly, their combined demand for raw materials, used to manufacture the vehicles, would likely drop. However, developing countries will maintain their production levels – firstly because they have no other equally significant source of income, and secondly because of the difficulty in shifting an export profile. Essentially, several developing countries will compete to export a commodity in a shrinking market; and the over supply will cause a drop in market value (Coote 1992: 29). The irony, in spite of this, is that government officials throughout the African continent are generally issued brand new European motor-vehicles when they enter office (Walsh 2002: Internet). Therefore, regardless of a hypothetical or actual drop in demand for input products, Africa remains an affluent market for their finished products.

It appears that developing countries that are highly dependent on raw material as a revenue stream risk the probability of falling into a commodity trade trap. Although, such a trade profile is not technically imposed and/or prescribed, it can be regulated. Trade barriers, for instance, can repel attempts at diversifying trade. The lack of resources and technology also constrain industrialisation. Draper (2003: 4) claims that trade analysts who argue that developing countries have increased their share of 'manufacturing' exports, should not conveniently omit that the manufacturing is of a resourced-based nature, rather than technology-intensive. Concurrently, developing countries that inadvertently 'over rely' on their developed counterparts for consumer products (processed or finished goods) without reservation thus risk the possibility of not being able to cultivate a domestic industrial capacity of their own. Reservations in international trade usually take the form of protectionism, which prompts the analysis of the next key issue for developing countries vis-à-vis the free trade agreement. How does an FTA jeopardise the income of developing countries?

3.5.2 Protectionism – A De Facto Revenue Stream

A tariff is a form of tax that is levied on imported goods, and which generally falls under one of two categories: a revenue tariff or a protective tariff. A revenue tariff is levied on imported goods that are not produced in the domestic market. A protective tariff, on the other hand, is levied in order to protect the domestic industry from foreign competition. However, by the mere fact of its levy the protective tariffs, although unintentionally, also generate a revenue stream (Sawyer & Sprinkle 2003: 127). Developing countries generally impose protective tariffs in order to enable industrialisation. However, at what point does a protective tariff no longer serve the purpose of domestic capacity-building and become a business of its own? Should the market 'protection' be confined to a specific timeframe? These questions raise ethical concerns about the use of tariffs for protectionist trade policies. A revenue tariff overtly generates an income, due to lack of local production. However, should the tariffs encourage countries to financially profit from their trade barriers? The only significant international body currently mediating such trade matters is the WTO.

The WTO is principally a regulator of trade between its members. However, it is by no means conclusive that all its members share equal terms of trade with each other. Beyond the mandate of the WTO, several countries maintain varied levels of protectionism targeted at specific sectors and/or sub-sectors as well as against specific countries. As previously mentioned, protectionist policies generally take the form of tariffs and quotas. Non-parties to an FTA would therefore be liable to pay taxes when trading, which generate income. However, under an FTA agreement circumstances would be different, as the tariffs are reduced and/or eliminated (Makwavarara & Deve 2005: Internet). Therefore, the repercussion for developing countries that enter into preferential trade agreements is the probability of a significant loss of revenue. To refer back to SEFTA, the launch of the TDCA caused SACU to lose customs revenue from its most dominant trading partner. Although South Africa was prepared to bear the loss, the same cannot be said for the BLNS countries.

Despite its intentions NAFTA was not perceived as an expression of free trade liberalism, but rather that of neo-mercantilism (Cooper 1999: 232). Certain political analysts believed that the USA was and continues to place greater emphasis on bilateral and regional relations, especially to demonstrate its autonomy from the WTO, Europe and Japan. Krueger (2000: 761) notes that this is a change in the USA's position on free trade, from a 'two-tack' approach to what is currently observed as preferential trading arrangements with various parties. As a result, although the USA remains devoted to trade liberalisation, its commitment to the multilateral system under the WTO is now undermined. Taking this into consideration, there has been debate over whether NAFTA thus serves either as a building block or perhaps even an obstacle to multilateral trade (Cooper 1999: 231).

3.5.3 Industrialisation: Development Models and the Hypocrisy of Free Trade

Developed countries share one fundamental common thread – their industrial capacity. However, what sets their experience of the 'industrial revolution' apart from the development models prescribed to developing countries? Coote (1992: 104) claims that the answer is Mercantilism. He explains that the economies of developed countries were built on diversified industries and sheltered behind high tariff barriers and trade restrictions. Then once the developed countries had established renowned industries, they sought foreign markets to trade. Yet, in the contemporary era the IFIs have enforced economic reform in developing countries through structural adjustment programmes[37]. Therefore, perhaps encouraging counterparts (developing countries) to open their markets is more a reflection of the trade agenda of the industrialised countries, than it is of their intentions to prescribe sound development policies to developing countries. According to Gilpin (2001: 200), it is for this reason that critics in developing countries

[37] For more information about SAPs, refer back to section 2.6.1.

view free trade as a form of imperialism – a means of forging and perpetuating a dependence on the developed countries.

To date, the alleged hypocrisy prevails in trade negotiations, bilateral and multilateral. Even during the TDCA negotiations, critics observed certain indiscretions. Despite the major trade disparity between the EU and South Africa - US$8 trillion and US$ 230 billion respectively – South Africa's DTI commented that the EU was extremely protectionist during the TDCA negotiations. Instead of negotiating 'free' or 'fair' trade, the EU seemed predisposed to simply negotiating terms that would manage trade (Lee 2002: 91). This point is reiterated by Draper (2003:2), who mentions that "developed countries still retain significant protection of key sectors of their economies, whilst seemingly hypocritically exhorting developing countries to open their markets." Trade analysts concur that reckless market liberalisation tends to result in the dumping of cheap imports. When a developing state is at the receiving end of market dumping, the ramifications can be severe. It results in unfair competition, which then undermines and undercuts domestic industries. Surprisingly or perhaps predictably, NAFTA does not have a concrete regulatory framework against dumping. It leaves the issues of anti-dumping and countervailing duties for each state to address according to its national trade laws (Cooper 1999:238). In the case of the TDCA, indemnity clauses do provide South Africa with means of safeguarding its domestic industries. However, this does not refute the high discrepancies between the economic policies implemented in West and those they recommend to developing countries under the auspices of IFIs. Draper (2003:20) commented that trade liberalisation generates winners and losers. Since there are always substantial risks to guard against, some areas of the economy will require delimiting protection. As WTO members, countries will need to comply with its terms of trade liberalisation. However, due to certain constraints experienced in the Doha Round, countries will seek to secure reciprocal market access with strategic partners.

3.6 Conclusion

This chapter has presented an empirical study of the concepts bilateralism and free trade agreements. The objective of a free trade agreement is to reduce and/or eliminate the barriers to trade. Much a result of the WTO's inability to consolidate the requirements and accommodate the dynamics of all its members, individual states and regional organisations resort to other channels of addressing their trade matters.

The free trade agreement, from liberal trade theory, offers its signatories exclusive access to each other's markets according to agreed specifications. Therefore, without the hassle of attempting to reach a consensus between over one hundred WTO members, eager and willing states may reduce trade barriers against similarly accommodating partners. Conservative scholars and academics initially believed an FTA could only be signed between partners of equivalent economic standing. However, the current trend proves otherwise. In 1994 Mexico became the first developing country who entered into an FTA with more developed countries, and it set a trend. Despite its popularity, critics delivered valid concerns regarding its economic sustainability and potential ramifications.

The two case studies examined in this chapter provide insight into the challenges that are apparent in the respective developing countries. Although the maquiladora investments in Mexico have proven to diversify the economy substantially and create employment, NAFTA's effect on the micro-economy is irregular. The competition has devalued the cost of consumer goods, but has also perpetuated the income disparity at sub-regions and across the country. When comparing this to the TDCA, the EU and SA do not share a border and so are not likely to share all of the same experiences. However, both case studies involve an FTA between a developing country and its most dominant trade partner, which in both cases also happen to be the world's top two strongest economies – the USA and the EU. What then are the implications of an FTA between a developing country and a much stronger economy and/or a more sophisticated market?

It appears that the FTA may, in principle, encourage the sustainable economic development of the weaker state. However, it may also be exploitative and may perpetuate a dependency complex. What does this mean for SACU and its prospects of a SACU-China FTA? Interestingly, there may not be one case study that can sufficiently tackle all the issues that will be raised concerning SACU and China. In both case studies that are examined in this chapter, the developing countries partnered with trade blocs that had existing preferential trade systems. Mexico partnered with the US – Canada FTA, and SA partnered with the 15 states (now 27) of the EU. Additionally, the USA and the EU are the most dominant trade partners of Mexico and South Africa, respectively. Yet, Mexico and South Africa make trivial contributions to the trade profiles of their respective counterparts. The partners' different levels of development are also strongly emphasised by their wide economic gap. In the case of SACU and China, increased trade has enhanced China's ranking as one of the region's most dominant trade partners. Yet, SACU, like Mexico and South Africa, is not as an important trade partner for China. A delicate issue in this case is the fact that the 'weaker' economy is the one that has a pre-existing preferential trade system, but that does not have a regional development strategy or synchronised economic policies across its member states. The next chapter provides a historical analysis of SACU, highlighting intricate details about the region's geopolitics and its economy. Furthermore, in order to critically assess the possible implications of a SACU-China FTA, Chapter 4 also examines SACU's history with China.

CHAPTER 4

HISTORICAL OVERVIEW OF THE SOUTHERN AFRICAN CUSTOMS UNION AND ITS RELATIONS WITH CHINA

4.1 Introduction

What are the prospects for a free trade agreement between SACU and China? More importantly, what possible implications would it have on Southern African businesses and industrial development in the region? These are just a few of the key questions asked in this dissertation. In Chapter 2 a discussion of trade theory was provided; the principles examined apply to trade between countries in a regional organisation, like SACU, but also apply to bilateral trade arrangements. The purpose of this chapter is to provide a historical overview of SACU, as well as of its relations with China. International trade theory offers contending perspectives to interpreting regional integration in SACU, as well as SACU's relations with the rest of the world. In practice, however, it is not always clear which theory(ies) is most applicable and/or accurate. Should normative theory compliment the empirical day-to-day practices? Or should the administration and management of trade sway between pragmatism and idealism? Whatever the approach, there are benefactors who may not necessarily be equal but who choose to engage in international trade nonetheless. This chapter has two parts: a historical analysis of SACU; and a descriptive account of SACU's history with China.

First is a historical overview of SACU, starting in the late 19th century when early discussions began. This section chronologically details the progress made in SACU from its creation in 1910 until the recently amended agreement in 2002. A critical understanding is required to asses certain key characteristics of the SACU economies, which will also be identified and examined. One of the objectives of this thesis is to evaluate the potential impact of a possible free trade agreement with China for the region's industrialisation. However, upon close re-examination it will be revealed that the region's industrialisation had historically been biased against BLNS states. For this reason, the impact of a bilateral FTA with China would bring new challenges to SACU and also significantly to the BLNS countries.

Second is a chronological account of the development of relations between SACU and China. This section is divided in three phases: the era of independence between 1949 and 1979; the period between 1980 and 1995 when relations were enhanced; and the current period of accelerated economic and trade relations, which began in 1995.

This chapter reports the development of a political alliance between SACU and China, which has led to their current trade relations. Upon consensus, increasing trade tends to lead towards negotiations for more favourable terms of trade. The possibility of an FTA and the implications thereof are not to be assessed in this chapter, but rather in the next chapter. The purpose of this chapter is thus less analytical, as it is predominantly historical and descriptive. However, an analytical account of the structure of SACU is provided so as to formulate the basis upon which comparison will be made on account of the sustainability of southern African industries should an FTA arise between SACU and China.

4.2 Historical Overview of the Southern African Customs Union

4.2.1 'A Vision for the Union of South Africa Inclusive of High Commission Territories'

Reflecting upon the creation of SACU, in the study of International Political Economy, the organisation may perhaps be considered avant-garde. SACU is not only the most advanced form of regional integration in contemporary Africa, but it is also the world's oldest customs union (SACU 2007: Internet). The dawn of a southern African customs union dates back to 1889 when the British Colony of the Cape of Good Hope and the Orange Free State republic signed the Customs Union Convention (Gibb 1997: 73). Whilst it is beyond the scope of this paper to present a thorough history of colonisation in southern Africa, it is important to note that as of the late 1800s until the conception of SACU, South Africa and the present day BLS states were under British colonial rule and occupation. Present day Namibia was under German colonial rule and occupation until 1915 and then became a colony of South Africa.

In 1893 the British High Commissioner, which had administrative control over British Bechuanaland (Botswana) and Basutoland (Lesotho), coordinated the incorporation of its colonies into the Customs Union Convention. After the Angola-Boer war (1899 -

1902), the shift of power invalidated the 1898 negotiations for a second customs union. England had then officially established colonial rule throughout the region – namely in Basutoland, Bechuanaland, the Rhodesias (Zambia and Zimbabwe), present day South Africa, and Swaziland. Under the authority of the British colonialists, it was easier to negotiate a new customs union for the region. Subsequently, the 1903 Customs Union Convention was signed between the Cape, Natal, the Orange River Colony, the Transvaal and Southern Rhodesia. Afterwards Basutoland, Bechuanaland and Swaziland - the so-called High Commission Territories (HTCs) - were then admitted to the Convention, but only barely under a protocol that categorised them as inferior members with diminished rights. Once the Union of South Africa was formed in 1910, the Southern African Customs Union (SACU) officially came into existence (Gibb 1997: 73 - 74).

The exclusion of British High Commission Territories (HTCs) from the Union of South Africa is what prompted the creation of the Southern African Customs Union. The negotiations were launched in June 1910, with Britain and South Africa having declared their intention to incorporate the HCTs into the Union of South Africa (Gibb 1997: 75).[38] SACU provided institutional frameworks which were lacking in the HTCs, i.e. they did not have their own customs administrations. As such, their ability to manage their national economies was questioned. Furthermore, Britain and South Africa did not envisage that economic development in the respective territories would go beyond the extraction and exploitation of commodities for the export market. SACU was to provide institutional support to the High Commissions territories, as well as integrate their respective economies with that of South Africa. Herewith were the terms of the agreement:

- Free movement of manufactured products;
- A common external tariff to the rest of the world; and
- Customs distribution by means of a revenue-sharing formula.

The customs revenue was divided amongst the four signatories to SACU. According to the agreement, revenue would be shared in proportion to the amount of each country's external trade between the years 1907 – 1910. This precluded the possible fluctuation of

[38] The regional integration of SACU emerged from a colonial policy (Gibb 1997: 75). This is contrary to the contemporary rationale and sequence of integration.

external trade and proportions thereof by the member states. Since South Africa was the largest trading partner of the four parties during the cited period, it received 98.7 percent of the total revenue. This left a mere 1.3 percent to the remaining three HTCs:

- Basutoland received 0.88 percent;
- Bechuanaland received 0.27 percent; and
- Swaziland received 0.15 percent (Gibb 1997: 75).

The 1910 Customs Agreement lasted 59 years under the above-listed terms. The revenue-sharing formula remained static and failed to recognise variations in import and export. Over the years, South Africa's economy increasingly dominated the region. During the historical development of capitalism across the world, capital accumulated predominantly in South Africa and led to the creation of a regional sub-system in southern Africa. The remaining territories became subjugated to serve the needs of South Africa – for supplying it with labour reserves, cheap raw materials, and a market for South African products (Davies & O'Meara 1990: 182). In 1954 Britain adjusted its foreign policy towards the HTCs, by announcing its support of economic development in the three nations. However, since it still maintained a policy of appeasing Pretoria, all development projects in the HTCs were to feed into the needs of the South African economy. This condition was set to restrict independent projects in the HTCs that could shift the orientation of their economies away from South Africa towards the international market (Bischoff 1990: 59-60). Hence, even the Lesotho Highlands Water Project (LHWP), which is one of the country's largest development projects and began in the late 1950s, was initially intended to supply water to South Africa.

This was during a period in time when South African manufactured goods were disproportionally uncompetitive with those in the international market, inflated at nearly 25 percent above the market price (Leistner 1992: 170). In theory, since the premise of a customs union is a common external trade policy, if a country were to independently modify its national policy towards international trade it would inherently affect the remaining members of the customs union. In 1925 South Africa adopted an import substitution programme in an effort to promote industrial growth. Trade barriers were thus consequently enforced around SACU. As the intended future regions of the Union of South Africa, the HTCs were also supposed to benefit from the new protectionist programme. However, their persistence for independence and self-determination had unfavourable inter-related repercussions:

- *The regional trade barriers prompted trade diversion*. HTCs were compelled to import high-cost South African products.
- *The level of customs revenue as a portion of GDP began to drop*. The trade barriers discouraged trade with the rest of the world. The decline in external trade meant a drop in revenue irrespective of the static formula.
- *Industrial development, resulting from the trade barrier was polarised.* As the instigator of the programme, South Africa was also the main benefactor (Gibb 1997: 75).

Almost two decades into the agreement the HTCs voiced their dissatisfaction with the customs agreement, urging for the renegotiation of the revenue-sharing formula. In 1948 South Africa legislated its apartheid system, negating Britain's aspirations of incorporating the HTCs into the Union of South Africa. Once South Africa left the Commonwealth in 1961, Basutoland (Lesotho), Bechuanaland (Botswana) and Swaziland took a stern position in voicing their dissatisfaction with the 1910 SACU agreement (McCarthy 2003: 612). However the negotiations for its revision, which began in 1963, were subsequently deferred until the independence of the former British colonies. Botswana and Lesotho gained independence in 1966. After Botswana, Lesotho and Swaziland (BLS)[39] submitted a joint counter proposal to South Africa in early 1967, South Africa eventually accepted the proposal almost a year later – once Swaziland's independence became official in 1968. The negotiations resumed shortly afterwards (Gibb 1997: 75-76).

Herewith were the main concerns of the BLS states cited in the proposal, which were not catered for in the initial agreement:

- The omission for protection of existing industries from new competitors;
- The right to protect infant industries from South African producers;
- Specific and extensive rights of consultation on all changes affecting the BLS countries, including tariff revisions;

[39] Namibia was not yet an independent state, and thus did not participate in the renegotiations.

- The right to specify organisations, such as the United Nations (UN) an other aid donors, to be given free import privileges;
- Guarantees against discrimination in agricultural marketing and transport in South Africa;
- A role in determining the tariffs on goods of major presence or potential importance to BLS;
- Lower duties on basic food and other goods consumed mainly by the poor;
- The right to raise revenue by applying higher excise rates than the South African ones (especially on alcoholic beverages), or by levying sales taxes;
- A greater increased share of revenue (Lundahl & Petersson 1991: 128).

In response, South Africa defended its right to maintain a leading role in the agreement, given the size of its economy and the spread of intra-regional trade in relation to the rest of the world. Amongst its demands South Africa sought privileged access to the BLS markets and freedom to determine customs, sales and excise duties unilaterally (Lundahl & Petersson 1991: 128). Although mutual consensus was eventually reached on a number of issues, some propositions were highly contentious and thus extremely difficult to resolve. For instance, the revenue sharing formula needed to be revised. Yet, having South Africa resume a leading role in the organisation perpetuated its hegemony in the region. South Africa's hegemony is a key characteristic of SACU that is critically analysed in the following section.

The outcome of the negotiations was a new SACU agreement that all parties collectively drafted compared to the previous one, which the BLS countries (former HTCs) were compelled to ratify. On February 12, 1969, the South Africa Act Amendment Bill was passed, revoking provisions made in the South Africa Act of 1909 that cited the possible incorporation of Rhodesia and the former HTCs into the Union of South Africa. The revised SACU agreement was then subsequently signed on December 11, 1969. The implementation thereof was initiated on 01 March 1970 (Gibb 1997: 75-76).

4.2.2 The 1969 Agreement

The 1969 agreement is more comprehensive than its preceding contract. At the core, it demonstrates a budding element of regional consciousness amongst the members. In the preamble it is cited that the agreement was to encourage the development of its less advantageous members and ensure the equitable distribution of benefits arising from trade within the customs union. This inferred the recalculation of the revenue-sharing formula and the implementation of a regional development strategy (Lundahl & Petersson 1991: 131). Three key features of the 1969 Agreement were as follows:

- An intra-regional trade policy and infant industry protection;
- A revenue-sharing formula for the Common Revenue Pool (CRP); and
- An extra-regional trade policy and common external tariff.

Once the BLS countries became independent, SACU members became highly cognisant of regional discrepancies - social, economic and political. The smaller countries were especially concerned that the customs union could have a degenerative impact on their economies. SACU's resolution was to draft a clause for the protection of the national industries in the BLS countries. The relevant terms to the SACU agreement on the subject comprise the following:

- ➢ *Article 6* empowered the BLS countries to issue a levy on additional import duties on goods sourced from within the customs union. However, the article only applied to 'new' industries – those younger than eight years and referred to in contemporary studies as 'infant industries';
- ➢ *Article 7* granted the BLS countries the right to impose customs duties on goods sourced from outside the customs union if they were of major importance to their respective economies.
- ➢ *Article 9* was reassurance of the good faith, bearing in mind the region's history and geopolitics. It stipulated that South Africa was to sympathetically consider all proposals brought forward by the BLS countries, in respect of *Article 7* (Lundahl & Petersson 1991: 135; SACU 1969: Internet).

The revenue-sharing formula was the most contentious feature of the 1969 Agreement. The economic link of the BLS states to the South African economy was considerably indissoluble. Furthermore, Lesotho and Swaziland appeared to be held captive by their geography for both being land-locked countries, Lesotho completely surrounded by South Africa. Nonetheless, the 1969 agreement offered a better deal than its predecessor – it made provision for financial compensation (Barber & Barrett 1990: 128; Taylor 1997: 75).

As per the agreement, member states were to pool their respective customs, excise, import surcharges and sales duties into one CRP which was managed by the South African Reserve Bank (SARB). The SARB's responsibility was two-fold. First, it would divide the CRP according to annual consumption of dutiable goods, imports and production. Second, it would subsequently compensate the BLS states at a rate of 42 percent. South Africa's share of the CRP was the residual sum remaining (Alden & Soko 2005: 371; Gibb 1997: 77). Therefore, while the BLS states received R6.5 million under the old agreement in 1969, a year later they received R17 million under the new formula (Barber & Barrett 1990:128).

Unlike the initial premise, the 1969 Agreement contained a central element designed to warrant its sustainability. It clearly stipulated its objective to promote economic development in all its member states on a basis of equity:

> to ensure the continued economic development of the customs union area as a whole, and to ensure in particular that these arrangements encourage the development of the less advanced members of the customs union and the diversification of their economies, and afford to all parties equitable benefits arising from trade among themselves and with other countries (SACU 1969: Internet).

Despite its omission of the term, the above clause pertains to regional development and economic integration through interdependence (Hentz 2005: 24). This would not only require high levels of political cooperation, but also a sophisticated mechanism of generating sustainable industrialisation in the less development countries. If not, the CRP could be viewed as a *de facto* subsidy to the BLS countries.

SACU continued to experience structural challenges for many more years. Its lack of a democratic decision-making process hindered the proportional representation of its members. Once the apartheid system in South Africa came to an end, the establishment of its own Government of National Unity instigated the renegotiation of the 1969 SACU

Agreement (SACU 2007: Internet). However, before proceeding with the subsequent 2002 SACU Agreement, it is necessary to briefly explore Namibia's entry into SACU. As a former colony of South Africa, South West Africa (present day Namibia) was by default a constituency of SACU. As such, once Namibia became a sovereign state it was automatically accredited membership to SACU as an equal partner.

4.2.3 Namibia's Official Entry into SACU

South West Africa, currently known as Namibia, was a German colony until the First World War (1914 - 1918). It was subsequently entrusted to South Africa by the League of Nations, which allowed South Africa to govern the colony effectively as its fifth province. The colony was consequently integrated into SA's political system, infrastructure and market (McCarthy 2003: 611). As such, South West Africa automatically became a *de facto* member of SACU in 1915. Much like the former HTCs, South Africa assumed the position of legal proxy for South West Africa as well as the remaining BLS countries. Even throughout the 1960s when the BLS states gained their independence, Namibia remained a part of South Africa.

Once the Republic of Namibia became independent in 1990, the sovereign state became the fifth member of SACU (SACU 2007: Internet). Remaining a member of SACU was only rational, taking into consideration that the country's trade and foreign exchange reverses had up until 1989 been recorded within those of South Africa. Furthermore, the pre-independence Namibia did not receive separate compensation in the customs union under the revenue-sharing formula (Gibb 1997: 77). Therefore as an equal member of SACU, the returns appeared far greater.

4.2.4 SACU in the New Millennium – the 2002 Agreement

The Southern African Customs Union has over the last century been prone to adjustments, especially due to shifting ideological and political dynamics in international relations – i.e. colonisation, the First World War, the Second World War, the political independence of colonised states, and the Cold War. At a regional level SACU survived the Union of South Africa, decolonisation, the apartheid era, and the emancipation of

South Africa. The new SACU agreement was subsequently signed in Gaborone (Botswana) on 21 October 2002.

The leaders of the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa and the Kingdom of Swaziland signed the SACU Agreement, cognisant of the autonomy their countries were each forfeiting, as well as of the benefits they each hoped to derive from the customs union. The organisation was no longer simply a political instrument used by its strongest constituent. It had become an autonomous organisation, which regulated trade and guided socio-economic relations in the region. The negotiation for the new SACU agreement demonstrated a consolidated effort towards simplifying the tariff regulations, opening decision-making and developing a better revenue-sharing formula (Hentz 2005: 32). The 2002 SACU Agreement clarified several points, which were either previously omitted and/or neglected by its predecessors. Foremost, the most distinguishing factor of the 2002 SACU Agreement is the legislation of self-governing institutions.

4.2.4a Institutional Setting

The governing structure of SACU in terms of the 2002 agreement consists of the following six institutions: the Council of Ministers; the Customs Union Commission; the Secretariat; the Tariff Board; the Technical Liaison Committee; and the Ad hoc Tribunal.

The **Council of Ministers** is the supreme decision making authority of SACU. It consists of at least one Minister from each of the member states. The Chair of the Council is held in turn by the respective member states, for a period of twelve months. The Council of Ministers is to convene at least once in each quarter of a financial year. The responsibilities of the Council include the following:

- Oversee the implementation of SACU policies;
- Appoint an Executive Secretary of SACU;
- Appoint the members of the Tariff Board;
- Approve the budgets of the Secretariat, the Tariff Board and the Tribunal; and

- Approve customs tariffs, rebates, refunds or drawbacks and trade related remedies (SACU 2002: Internet).

The **Customs Union Commission** consists of senior officials (i.e. Directors-General, and Principal Secretaries as well as other executives of equivalent rank) from each member state. The Commission reports to the Council of Ministers and is responsible for the implementation of the agreement. It supervises the work of the Secretariat and manages the Common Revenue Pool. The Commission convenes once each quarter of the financial year and also ad hoc upon request of a Member State (SACU 2002: Internet).

The **Secretariat** manages the day-to-day administration of SACU; it based in Windhoek, Namibia. Its duties include arranging meetings, disseminating information and keeping minutes of all SACU meetings. The Secretariat also coordinates and monitors the implementation of all decisions of the Council and the Commission (SACU 2002: Internet). The three main roles of the Secretariat are as follows:

- Ensure the harmonisation of SACU policies into the national policies and strategic papers of the Member States;
- Coordinate and assist in trade agreement negotiations with third parties; and
- Depository of all records of SACU, i.e. all transactions into and out of the Common Revenue Pool.

The Secretariat is currently led by Tswelelopele Moremi, who is serving as Executive Secretary of the organisation. Under her leadership, in 2007 SACU was notified to the WTO under Article XXIV of the GATT. This means that the five SACU countries are effectively considered a single customs territory (Moremi 2008: Internet). This should help to maintain the integrity of the common external tariff, especially now as SACU is increasingly involved in trade negotiations with third parties.

The **Tariff Board** is an independent institution, consisting of full-time and part-time technical experts recruited from Member States. It makes recommendations to the Council regarding customs, anti-dumping, countervailing and safeguard duties, rebates, refunds or duty drawbacks (SACU 2002: Internet).

The 2002 SACU Agreement categorises four **Technical Liaison Committees** to assist and advise the Customs Union Commission:

- Agricultural Liaison Committee;
- Customs Technical Liaison Committee;
- Trade and Industry Liaison Committee; and
- Transport Liaison Committee (SACU 2002: Internet).

The **Tribunal** is an *ad hoc* institution devised to settle any dispute regarding the interpretation or application of the 2002 SACU Agreement. The Tribunal comprises three members and makes decisions by a majority vote. When a matter is referred to the Tribunal, the disputing parties must choose the members of the Tribunal from a pool of names, which are approved by the Council and kept by the Secretariat (SACU 2002: Internet). The Tribunal is the only forum that is exempt from *Article 17* of the new agreement – i.e. all decisions of the SACU institutions are to be made by consensus.

4.2.4b Economic Policy Issues

As per the model prescribed for all custom unions, to which SACU is no different, there are two central features of economic policy: trade liberalisation and the common external tariff (see the theoretical framework in Chapter 2). The removal of trade barriers within the regional organisation promotes trade and investment across the borders between it members, through lenient custom regulations and special investment incentives. Furthermore, a policy on 'rules of origin' is adopted to prevent the deflection of trade (Khamfula & Tesfayohannes 2004: 43). As a result, the members of the customs union assume a common external tariff, for all imports from the rest of the world.

SACU promotes the free movement of domestic products in the common customs area. This consists of goods that are grown, produced or manufactured in SACU. However, the member states retain the right to impose trade restrictions in accordance with their national laws and regulations in order to protect the health of humans, animals or plants; the environment; public morals; national security; intellectual property rights; exhaustible natural resources; and treasure of artistic, historic or archaeological value.

Members may even apply identical drawbacks, rebates or refunds of customs duty on imported goods (SACU 2002: Internet).

Stipulated in *Article 38*, the SACU states recognise that industrial development as an objective to generate the economic development of the region. An attempt to harmonise national development plans is demonstrated in the agreement, as the SACU members plan to develop common policies and strategies with respect to industrial development (SACU 2002: Internet). In practice, a consolidated SACU industrial development programme would be ideal. However, formulating the industrial policy has proven to be a challenge. According to McCarthy (2008:26) there is still controversy surrounding the definition of an industrial policy and what it should entail. Different approaches place emphasis either on the development of a manufacturing sector, a service sector, or a calculated combination of both. There is also the question of whether an industrial policy should involve only mechanisms that would facilitate industrialisation versus whether it should target specific sectors of the economy? Therefore, although the SACU countries may recognise the significance of industrialisation for the region's economic development, they may not necessarily agree on the terms of industrialisation.

Mindful of the above, there is also debate over the appropriate balance of power between the state and the market in driving industrialisation and economic development. It is not clear whether SACU lacks the political commitment of its member states or if it lacks the authority and control that is required to steer this process. Bear in mind that the economies of the SACU countries function as liberal free markets and these economies are exceptionally inconsistent (McCarthy 2008: 11). Therefore, is it realistic to expect the countries to develop common industrial policies when their socio-economic variables are different? As parties of SACU, the smaller BLNS countries have a key interest is its revenue-generation mechanism. Engaging a much larger trade partner, like China, under FTA terms would put pressure on the region's businesses and industrialisation prospects. Almost immediately, it would even cause a substantially drop in customs revenue for SACU. Could the revenue derived from SACU perhaps be a significant point of inertia for its market liberalisation with third parties?

4.2.4c The New Revenue-Sharing Formula

The terms of the new revenue sharing formula are found in *Article 34* of the 2002 SACU Agreement. Customs, excise and additional duties collected by the SACU members during the financial year sum up the Common Revenue Pool (CRP). Each member's share of the CRP is calculated from three distinct components: customs, excise and development. However, prior to the distribution of respective shares the budgeted costs of financing the Secretariat, the Tariff Board and the Tribunal are deducted proportionally from the gross amounts of customs, excise and additional duties collected, for the specific financial year. To facilitate the revenue shares calculation, each member states is to annually submit forecasts for its customs and excise revenue to the Secretariat. The payments are made on the first day of each quarter of a financial year (SACU 2002: Internet).

The built-in compensation factor in the SACU agreement is one of its most distinguishing factors when compared to other regional organisations in Africa. This is SACU's approach to accounting for the negative effects of the customs union on its less developed members (Hentz 2005: 27). Monitoring and quantifying the negative effects of SACU on the BLNS countries would be a scrupulous task. However, the findings would essentially resonate around the following two main theories:

- The most advanced market attracts the majority of the investment, and thus continues to develop much faster than its partners; or
- The least developed markets import goods from the dominant economy, which may not necessarily be internationally competitive and rather quite often more expensive (Hentz 2005: 27).

The compensation in SACU was initially purely a political tactic to dissuade the industrial development of the BLS countries. As a result the BLS countries imported overpriced goods from South Africa on a daily basis, of which payments were made in hard currency. Although there still remains a huge trade deficit between the BLNS countries and South Africa, there is no clear evidence that determines whether the compensation has any positive effect on industrial development and economic diversification in the BLNS countries (Hentz 2005: 27). Instead, apart from their dependency on South African imports, the BLNS countries have become increasingly dependent on the income generated by the Common Revenue Pool. Due to the sensitive nature of the subject, the most recent statistics are not readily accessible. Nonetheless, the World Bank (2003: 7) estimated that in 2001/02 that SACU's payment accounted for 51 percent of the government revenue in Lesotho and Swaziland, 28 percent in Namibia, and 13 percent in Botswana.

In essence, there are discrepancies in SACU that are an historic legacy of the colonial and apartheid eras. However, there are certain shortcomings that demand a proactive reformulation of policy and structure. The 2002 SACU agreement managed to democratise decision-making and fill an institutional gap. Executive Secretary Moremi, believes that the trend towards multilateral trade liberation is even more of a pressing call for SACU to develop a Common Negotiating Mechanism (CNM). The CNM would formalise the organisation's trade negotiations with third parties and safeguard the integrity of the common external tariff (Moremi 2008: Internet). Even so, to debate this further certain dynamics in the region's geopolitics must first be examined.

4.3 Key Characteristics of the Economies of SACU

4.3.1 South African Hegemony

There are several factors in SACU's history that contributed to the hegemony of South Africa within the organisation. As previously mentioned, it was the intention of the British Government to incorporate the HTCs into the Union of South Africa. Accordingly, their respective national administrations were not institutionalised since they had each not envisaged economic development beyond their primary industries.

Articles 4 and 5 of the 1969 Agreement insinuate the presence of South Africa's hegemony. The former article stipulates that the BLNS countries were legally obliged to exercise a common external tariff structure that was to be unilaterally determined by South Africa. The latter stipulates that South Africa was to offer BLNS states an "*adequate opportunity for consultations before imposing, amending or abrogating any customs duty*." (SACU 1969: Internet). There are two terms used in this phrase that make this article the focal point of much debate regarding South Africa's alleged hegemony in the region, and these are 'adequate', and 'consultation'. Without placing unnecessary emphasis on semantics, their connotations cannot be ignored. How does one measure adequacy? In all fairness, it may be interpreted that an adequate opportunity would demand that sufficient time be granted in relation to one's ability to deliver on the task. Or is fairness irrelevant to measuring adequacy? Furthermore, South Africa's decision is only subject to consultation, not consensus and/or consent.

From the beginning the trends towards regional economic integration demonstrate disparities and an acute bias towards South Africa's development. While the principle poles of accumulation and industrialisation were established in South Africa, the rest of the region assumed the position of service economies (Davies 1990: 4). The *de facto* role of the BLNS states became to render the following services to South Africa:

- Ample and replaceable supply of labour force;
- Open market for South Africa commodities;
- Eager supplier of particular services (i.e. transport), and cheap resources (i.e. electricity, water and raw materials).

The question of South Africa's hegemony in southern Africa officially became an issue of regional security in the late twentieth century, which prompted the launch of the Southern African Development Coordination Conference (SADCC) in 1980.[40] The conference emerged as a critique of the social imbalances and economics disparities in the region. One of its main goals was to reduce its members' dependence on South Africa (Leistner 1992: 171). South Africa's foreign policy towards its neighbouring countries was premised on reinforcing ties of dependency, which for the BLNS states was partially legislated in SACU. Hegemony thus strengthened its economy and awarded South Africa with strategic leverage. SADCC's main objective was to encourage "*a reduction of external dependence and in particular dependence on the Republic of South Africa*" (Davies 1990: 4). In its place, interdependence would be met through the fair distribution of industries and investment amongst the members. However, developmental integration could only be implemented through strong state intervention (Hentz 2005: 24). This had historically been the case in SACU, where South Africa dominated over the BLNS countries; but even in SACU it was South Africa's economy that maintained priority over the rest.

[40] The founding members of the SADCC were Angola, Malawi, Mozambique, Tanzania, Zambia, Zimbabwe and the BLS countries.

In the contemporary setting, the issue of South Africa's hegemony in the region is contentious for geo-political and economic reasons. Corroborated by arguments presented above, both scholars and economists, suggest that South Africa's hegemony is a legacy of its foreign policy towards the region during the colonial period and the apartheid regime. More importantly, however, is the South African government's recognition thereof and its new-found compliance to change its foreign policy. During the transition period and negotiations for a democratic South Africa, the African National Congress (ANC)[41] and SADCC "*indicated that future cooperation between a democratic, non-racial South Africa and the rest of the region should be based on principles of equality, mutual benefit and inter-dependency, rather than hegemony and dependency*" (Davies 1990: 3).

The realist perspective on regionalisation assumes that one country tends to be much stronger than the rest. Furthermore, irrespective of how hegemony was assumed, the weaker neighbouring states will demonstrate traits of dependency – e.g. economic aid, financial services, professional expertise, infrastructure, etc. To counter such tendencies, significant progress has been made in SACU to reduce the level of dependency the BLNS states have on South Africa. The regional transport infrastructure has been reconstructed, giving all except Lesotho the option of liaising with the rest of the world without South Africa. Lesotho remains a land locked state, with its total 909 kilometer parameter completely surrounded by South Africa.[42] Although the BLNS states have made an effort to emancipate their transportation infrastructure, its impact on their trade with the rest of the world is minimal.

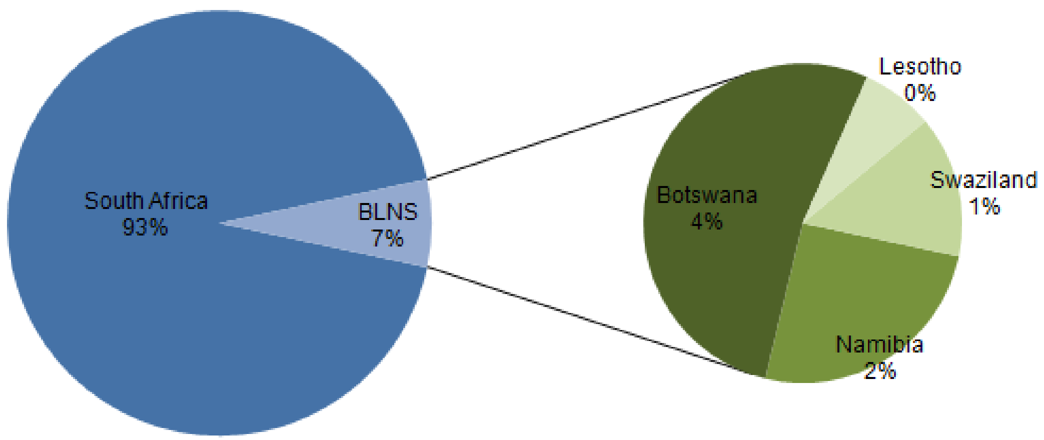
The balance of trade in SACU is heavily skewed in South Africa's favour, thus perpetuating its economic hegemony (McCarthy 2003: 625). Figure 4.1 illustrates this by sizing the composition of SACU's gross domestic product (GDP). South Africa accounts for 93 percent of SACU's GDP. Furthermore, 2007 GDP figures indicate that South Africa's economy is nearly 11 times more than the combined BLNS economies – i.e. US$ 467.6 billion and US$ 43.3 million respectively (CIA World Factbook 2008a,

41 The ANC was banned from operating as a political party in 1960, and subsequently assumed the position of South Africa's main liberation movement. It was unbanned in 1990.

42 An in-depth analysis of this issue, amongst others, is addressed in the next section (4.3.2. Weak Land-locked States: Lesotho and Swaziland).

200c, 2008d, 2008e, 2008f: Internet). Botswana has the strongest economy of the BLNS countries, which is exclusively a result of its mining industry. Lesotho and Swaziland have much weaker economies. They are also notoriously dependent on SACU's customs revenue, which is predominantly generated by South Africa's trade, and distributed in South African Rand (ZAR).

Figure 4.1: GDP Composition of SACU in 2007



Source: CIA World Factbook (2008a, 2008c, 2008d, 2008e, 2008f: Internet)

As part of the 1910 SACU agreement the South African currency became legal tender in all BLNS territories. A *de facto* monetary union was thus created in SACU, which was subsequently formalised in 1974 under the Rand Monetary Area (RMA) agreement between Lesotho, South Africa and Swaziland. Botswana, having declined to join the monetary union, established its own currency and central bank in 1976. In 1986 the Trilateral Monetary Agreement (TMA) replaced the RMA with the Common Monetary Area (CMA). Once Lesotho and Swaziland introduced their own currencies they were compelled, under the TMA, to fully back their issued currencies with ZAR deposits at the SARB and South African government stock. The TMA was revised in 1992 and replaced with the Multilateral Monetary Agreement (MMA) to incorporate newly-independent Namibia's entry into the CMA (Holden 1998: 460). A year later, Namibia established its own currency and central bank. Lesotho, Namibia and Swaziland still remain part of the CMA. In spite of the technical provisions made to delink the three countries from the South African rand, till this day their respective currencies remain on a fixed and equal exchange rate with the ZAR. The South African currency is also still a legal tender in both Namibia and Lesotho, but not in Swaziland.

4.3.2 Weak Land-Locked States: Lesotho and Swaziland

Lesotho and Swaziland are sovereign states; however they are both land-locked[43] – mostly by South Africa but Swaziland also borders Mozambique. Their geography thus makes them entirely dependent on their neighbours to access external linkages for inter-regional market access and routes of entry for their own imports. Strategically, this poses certain limitations to both countries, which can compromise their autonomy. Furthermore, as already noted above, the trivial size of their respective economies and/or industries in comparison to that of South Africa's further highlights their limitations. What are these limitations and what are their implications? At the outset, a realist view of South Africa's established hegemony in SACU can only leave Lesotho and Swaziland in one weak position, that of vulnerability. For instance, at independence Lesotho was already considered one of the world's poorest and least developed countries. It had a weak economy and was heavily dependent on South Africa. Petersson (2001: 248) comments that there was even considerable scepticism about its economic viability. Economic development, like in most developing countries, was required to alleviate poverty, malnutrition and unemployment. Most importantly, Lesotho needed to fast-track its development to in order to sustain its sovereignty.

Once national independence was granted, Lesotho (in 1966) and Swaziland (in 1968), these states sought to demonstrate their autonomy to the rest of the world. While establishing new diplomatic relations with South Africa, Swaziland kept a low profile and Lesotho did quite the contrary. In 1967 Chief Leabua Jonathan, Lesotho's first black Prime Minister, visited Pretoria on his first official state visit and was received by South African Prime Minister John Vorster. Vorster offered the Chief technical assistance and political counsel, but failed to acknowledge the Chief's most important request – to exchange diplomats (Barber & Barratt 1990: 129). Months later South Africa's relations with the BLS countries became strained, which prompted the revision of the SACU agreement. In 1972 Lesotho openly condemned South Africa's racist regime; then in

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[43] See Illustration of SACU in Africa on page x.

April 1975 Vorster labelled Lesotho an extremist state. By 1986 the relations between countries had deteriorated even further and culminated in an economic blockade of Lesotho in January 1986, which led to a military coup. Despite Lesotho's economic dependence on South Africa, these two events pioneered the political tension that both states experienced over the following decade (Barber & Barratt 1990: 130; Peterssen 2001: 254).

In liberal theory the process of internationalisation and regional integration is supposed to generate economic development and the efficient use of scarce resources. However, certain variables in the case of Southern Africa distinguish the interpretation of that premise for critics. Radical theory suggests that under the current circumstances small countries, like Lesotho and Swaziland, would develop a dependency relationship with a country like South Africa. Furthermore, the dependency may also become a source of conflict between the states. Liberal theory will have one believe that the relation is one of complex interdependence. However, the empirical evidence provided below will corroborate that Lesotho and Swaziland need far more from South African than vice versa. Furthermore, the evidence will even suggest that South Africa's position of hegemony (discussed above) enunciates the vulnerability of the smaller nations (Lundahl & Petersson 1991: 12).

One of the pillars of modern industrialisation and accelerated development is knowledge and the intellectual output of one's population. Lesotho and Swaziland face enormous challenges in trying to prevail over their rapid labour migration and brain drain. One of the greatest links these two countries share with South Africa is their export of labour, perpetuated by a lack of exploitable domestic resources. For instance, during the 1970s migrant workers from these two countries earned much better wages in South African mines compared to the domestic wages in their agricultural sectors (Petersson 2001: 248 & 251). By 1985 there were over 150,000 Basotho and SiSwati migrant labourers registered in South Africa, of which approximately 80 percent were employed in the mining industry and the rest in agriculture and manufacturing (Davies 1990: 13).

In 1984 migrants accounted for nearly 86 percent and 15 percent of wage-earning labour forces in Lesotho and Swaziland, respectively (Davies 1990: 14). Therefore the transfer payments across borders become an important source of revenue, providing a livelihood for communities across both countries. Over time the habit of immigrating for employment in South Africa was no longer restricted to mine workers. Lesotho and Swaziland now also suffer from brain drain. Countries generally import input products when they lack productive resources and raw materials to produce themselves. However, developing the industrial capacity to produce goods also requires capital investment and skilled labour (Lundahl & Petersson 1991: 13). Yet, Lesotho and Botswana lack both the financial capital and the human capital. Furthermore, without their earnings from the common customs pool of SACU, Lesotho and Swaziland may even struggle to balance their accounts.

Much in line with the initial purpose of the former HTCs, post apartheid South Africa has continued to market its products and services in the respective countries. As for Lesotho and Swaziland, being exceptionally small markets, trade with South Africa has not only flooded the market but may be interpreted as a latent form of dumping. Critics refer to it as 'South Africanisation' (Naidu 2004: 211).

Many scholars believe that South Africa's foreign policy suffers from an identity crisis, frequently taking note of inconsistencies in the actions of government and those of the corporate sector. The foreign policy of South Africa's pre-1994 government was generally aggressive and swift to intervene/interfere in the domestic affairs of other states. (Naidu 2004: 206). Even in 1998, South Africa led the SADC military intervention in Lesotho. On an official capacity, South Africa has no jurisdiction in Lesotho and Swaziland. However, the region's geopolitics is not immune to SACU's history. By publicly announcing that SACU and China intend to negotiate an FTA, did the South African government overlook, or perhaps overrule, the fact that Swaziland does not have diplomatic relations with the PRC?

4.3.3 Botswana - The Importance of Industrial Diversification

Botswana has one of the best performing economies in Africa, its GDP in 2007 stood at US$ 11.35 billion (CIA World Factbook 2008a: Internet). This Southern African country is the only one of SACU members whose currency, the Pula, is not pegged to the South African Rand (ZAR). Instead, the Pula is linked to a basket of currencies including the ZAR. Botswana's good fortune was triggered in 1967, when a group of De Beers geologists found traces of ilmenite and garnet while working near the village of Lethakane – north central of the country. Today Botswana is now one of the world's largest producers of gem quality diamonds (Novellino 2006: 23).

For nearly three decades, from its independence in 1966 to the mid-1990s, Botswana had an average annual growth rate of more than 10 percent. During this period the country had the fastest growing economy in the world, even surpassing the 'Asian Tigers'[44]. However, diamond-led growth has risks, especially if the current explorations prove futile and no new mines open. In 2004 and 2005, Botswana's rough production averaged at 31.5 million carats each year. As the reserves become depleted, experts have forecast declining levels of production by 2017 to approximately 25 million carats (Novellino 2006: 23). Mining already accounts for 36 percent of the country's GDP. In order to cushion the shock of reduced income, resulting from lower production, Botswana has been setting up world-class cutting and polishing plants in the country. Since Botswana does not yet have a competitive luxury goods profile by international standards, it aims at least to market the bulk of its mining exports to jewellery designers.

The demand for luxury goods is unremitting, as it caters for a very small but lavish niche market. However, a small market is also more susceptible to external forces that can be detrimental. For instance, allegations of child labour and 'blood diamonds'[45], which are notorious in Africa, may affect the marketability of luxury goods. Such indiscretions can influence consumer spending and similarly prompt consumer boycotts (African Business 2006: 17). Furthermore, Botswana's economy is vulnerable to the volatile changes in commodity prices, especially considering there is minimal value-add before export.

Botswana has a population of 1.83 million people, and a GDP per capita rate of US$ 14,700 (CIA World Factbook 2008a: Internet). Countries with such small domestic markets tend to integrate themselves into the global economy in order to sustain employment levels, and generate economic growth. As such Botswana will need to implement export-driven diversification that will take its economy beyond its current dependency on diamonds and yield significant foreign currency (African Business 2006:

[44] The 'Asian Tigers', also dubbed the 'Tiger Economies', are Malaysia, Singapore, South Korea and Thailand.

[45] 'Blood diamonds' are mined illegally and often during the course of a civil war.

17). This is the objective of Botswana's *Ninth National Development Plan for 2003 – 2009*, which specifically targets the financial sector and tourism for growth. It is Botswana's intention to market itself internationally as a new hub for cross-border financial services, thereby competing with Mauritius and South Africa. Mauritius, in spite of its limited human capital, operates a large offshore financial sector. Regarding Botswana's prospects in tourism, it has one of the world's unique ecosystems – e.g. the Okavango Delta. The Chobe Game Reserve and the Central Kalahari Game Reserve offer game viewing, birding and some of Africa's most remote and well-preserved wilderness (Fittipaldi 2004: 32-33). In theory, finance and tourism are feasible industries that have been indentified to channel economic diversification in Botswana. However, the question remains whether these two sectors could sustain Botswana's economic growth. If not, what effect would it have on Botswana's socio-economic indicators? What effect would this have on SACU?

In this brief look into Botswana's economic profile, it is apparent that the country's narrow economic base is reason for concern. Mineral commodities run the risk of depletion and Botswana currently has no equivalent substitute in terms of earnings (Africa Monitor 2007: 10). In the context SACU and the possibility of an FTA with China, this raises several concerns that will be explored in the next chapter. In view of Botswana's focus on mining, does the country have the necessary infrastructure to receive Chinese investments without infringing the operational environment for infant industries that will sprout during its anticipated economic diversification?

4.4 SACU's History with China

The friendly association between China and Africa dates back thousands of years, as early as the second century before Christ (BC). Proof thereof lies in the robe of Cleopatra VII (69 BC – AD 30), the Egyptian Queen during the first century BC, acclaimed to have been made from Chinese silk. This half of the chapter details the progress of diplomatic relations between SACU and China. Having recently joined the WTO in 2001, China now seeks to secure its access to fundamental resources needed to sustain its manufacturing capacity. After South Africa's signing of the TDCA with the EU, SACU members have come to recognise the importance of intra-SACU collaboration in negotiating bilateral/external trade agreements. This incident was also demonstrative of the geopolitics and challenges that are inherent of SACU. In view of this, herewith is a historical account of how SACU's relations with China progressed since 1949.

4.4.1 The Era of Independence: 1949 – 1979

Diplomatic relations between SACU and China date back to the 1920s; this was when Chiang Kai Chek's nationalist party seized control of mainland China. The relations persevered a major change in China's leadership, when Mao Tse-tung's communist movement established the People's Republic of China (PRC)[46] in 1949. The ousted nationalist party subsequently established a parallel government on the island of Taiwan, which became known as the Republic of China (Naidu 2005: 459).

The PRC was founded on October 1st, 1949. As a new state in the international arena, China sought to establish diplomatic relations with countries around the world including those in Africa. China was sympathetic towards African countries, having shared a similar history of colonial rule. The PRC therefore offered both political and moral support in the struggle for the national independence of African states (Yuan 2006: 30). Yet despite the Chinese Communist Party's (CCP) promotion of anti-colonialism and racial equality, it pursued diplomatic relations with South Africa's apartheid government and the BLS states (Naidu 2005: 460).

With the exception of Egypt, Ethiopia, Liberia and South Africa, China's attempt to establish diplomatic relations with the remaining African states was deterred by colonial rule. The lack of foreign recognition meant little interaction between China and Africa, and no confrontation until the tone of segregation in Southern Africa intensified. In July 1950 Mao Tse-tung joined the protest against a proposed apartheid legislation, which he perceived would discriminate against the Chinese minority in South Africa. A few years later, China began to take a keen interest in Africa and the anti-colonial movement, which strained its relations with the South Africa and the BLS countries.

[46] Unless otherwise stated, in this paper all references to the People's Republic of China (PRC) and China refer to mainland China.

The first official diplomatic encounter between the PRC and African states occurred during April 18th – 24th of 1955, at Bandung in Indonesia. Of the twenty-nine states represented at the Asian-African Conference, six of them were from Africa – i.e. Egypt, Ethiopia, Gold Coast (Ghana), Liberia, Libya, and Sudan (Larkin 1971: 16). By this time, China had also already begun courting members of the African National Congress (ANC). For instance, Walter Sisulu (1912 - 2003), secretary of the ANC, met with Chinese officials in 1951 at the 10th World Youth Festival that was hosted in East Berlin. Subsequent to this introduction, Sisulu visited China in 1953. During this time the ANC was a registered political party that was advocating for the emancipation of South Africa.

The Bandung Conference endorsed the United Nation's Universal Declaration of Human Rights, as well as generated support for the right to self-determination of peoples and nations. During the conference, certain delegates expressed their concern for nations that were still under colonial oppression, domination and foreign subjugation (Le Pere & Shelton 2007: 70). In the context of the SACU region, the struggle for liberation had already begun in the HTCs. Condemned by the international community, South Africa's foreign relations became strained. By the late 1950s South Africa became apprehensive about China's support of liberation movements and its growing solidarity with the 'colonially oppressed'. The apartheid government decided that continuing relations with China would undermine its national interests, both economic and security, as well as the stability of the region. Official ties between South Africa and the PRC ended in July 1960 (Naidu 2005:460).

During this period, SACU's priority was mostly economic. The organisation's lack of an official regional trade policy enabled South Africa to dominate internationally and further its own national interests in the process. South Africa's ideological preferences, which were similarly domineering in the region, therefore guided the foreign policies of the BLS countries. Compounding tension was the PRC's denunciation of the apartheid government, which dissuaded diplomatic relations with the remaining SACU members. The geopolitics in the SACU region pressured Botswana and Lesotho to adopt a foreign policy of 'non-alignment'. It enabled them to diversify their international relations without taking a definitive position on the issue of South Africa. Their neutrality meant they would not engage with countries that had anti-racist and anti-colonialist policies towards South Africa. Even so, Botswana pursued relations with communist countries and supported Communist China (the PRC) in the UN (Bischoff 1990: 287; Bodenmüller 1973: 75).

With regards to the rest of the continent, China stimulated diplomatic relations with the newly independent states of Africa in 1963/4 when premier Zhou Enlai led a high-level state delegation to ten African countries (Le Pere & Shelton 2007: 18). Half way through the 1960s the PRC had pledged nearly US$ 350 million in development aid to African countries, and another US$ 484 million to finance the longest railway in Africa from Tanzania to Zambia, which is now known as Tan-Zam or Tazara. Completed in 1975, the Tazara is an important linkage for land-locked Zambia (Larkin 1971: 2; Le Pere & Shelton 2007: 58). Geopolitical alliances in a sub-region are a delicate issue of national security for land-locked states. Therefore although Zambia freely engaged with the PRC at no consequence, the BLS countries could not autonomously pursue foreign policies that would contradict that of South Africa. By the end of 1966 Botswana and the Republic of China (ROC), also known as Taiwan, established diplomatic relations (Taylor 1997: 76).

A profound gesture of harmonious diplomatic relations between China and African countries was demonstrated in 1971. At the General Assembly of the UN, twenty-six African countries voted in support of China for it to assume a permanent seat on the UN's Security Council. During these trying times in global politics, China offered the developing countries the greatest political prospects in the global struggle to restore a balance of power (Le Pere & Shelton 2007: 19 & 66). Caught between the ideals of the communist Soviet Union and the questionable apartheid system of South Africa, the BLS countries began to pursue diplomatic relations with the non-aligned countries of the Third World. Zambia was Botswana's only black-ruled neighbouring state, unlike Rhodesia (Zimbabwe) and South Africa. As such, Zambia became Botswana's foremost regional ally, to the extent that Botswana delinked its national currency from the South African Rand in 1974 (Taylor 1997: 77). The following year, Botswana established diplomatic relations with the PRC (China.org 2009b: Internet)

In South Africa, the apartheid government was having a hard time maintaining its own balance; its political ideology and racial discrimination began to impinge on its foreign relations. As countries rolled out sanctions against the South African government, the country became extremely isolated in the international community. Consequently it pursued relations with other rogue nations – i.e. Israel, North Korea and Taiwan. In 1976 South Africa established official diplomatic relations with Taiwan, and prompted Lesotho and Swaziland to eventually follow suit.

4.4.2 Refining Diplomatic Relations: 1980 – 1995

Premier Zhou's visit to African states in 1963 set a precedent for future political leaders of the PRC. High-profile visits to Africa continued throughout the 1980s into the turn of the new millennium. During the period of 1980 to 1995, herewith are some of the visits that took place:

- Premier Zhao Ziyang in 1982/3
- President Li Xiannian in 1986
- Premier Li Peng in 1991 and 1995
- President Yang Shangkun in 1992 (Le Pere & Shelton 2007: 19).

In 1982 and 1983 Premier Zhao Ziyang visited eleven African countries, and identified four new guiding principles to China's foreign policy towards Africa:

- No conditions and/or conditionality would be attached to its aid regime;
- Development projects would to yield practical solutions and offer socially beneficial results;
- Projects would promote self-sufficiency; and
- The cooperation agreements shall be honoured by both parties (Le Pere & Shelton 2007: 79).

Although China heavily engaged Africa during this period, its focus was primarily on countries in East and West Africa. Chinese operations in these regions involved setting up communications systems, varied construction and utilities projects, and agriculture. However, in southern Africa the Cold War was endemic and became the PRC's vehicle for refining diplomatic relations in Southern Africa. The CCP offered its support to liberation movements, namely the African National Congress (ANC) and the Pan Africanist Congress (PAC). Although the ANC received most of its support from the

Union of Soviet Socialist Republics (USSR), PAC activists went to China where they received various kinds of assistance including education and military training. Despite its condemnation of the apartheid government, China retained clandestine economic relations with South Africa. The CCP claimed that it wanted to uphold its relations with all the potential role players in a post-apartheid era (Naidu 2005: 462).

Lesotho was the second BLNS state to establish diplomatic relations with the PRC, in 1983. Namibia established diplomatic relations with China in March 1990, the same year it became a sovereign state. A few months later, in April 1990 Lesotho's military government severed its relations with the PRC by assuming so-called diplomatic ties with Taiwan. PRC-Lesotho relations were resumed in January 1994, by the Basotho Congress Party (China.org 2009a: Internet).

4.4.3 Accelerated Economic and Trade Relation: 1995 until present

China's foreign policy has shifted slightly over the recent years. In the past it had given absolute priority to its relations with global powers. Former President Jiang Zemin promoted China's relations with the USA as a prerequisite for his country's economic development (Le Pere & Shelton 2007: 19). African leaders adopted similar foreign policies towards the West. Their relations encouraged the adoption of structural adjustment programmes (SAPs), recommended by the World Bank and the International Financial Corporation (IFC), which afterwards proved to be ineffective and detrimental. The disappointment prompted dialogue in the global South for countries to share their experiences and approaches to development.

The majority of post-cold war scholarly literature in political sciences suggests that democracy, based of the notions of a representative government and a free market, is more conducive to socio-economic development. Yet in spite of China being a feudal state, it had a double-digit GDP growth rate during the 1980s and an average growth rate of 9.7 percent during the 1990s. The growth rate slumped to 4.5 percent during the first half of the twenty-first century, but subsequently peaked at 11.4 percent in 2007 (CIA World Factbook 2008b: Internet; Thurow 2003: 203). As such, there is growing interest amongst African leaders to learn from China's experience of industrialisation and economic development as an alternative model to industrial development.

In 1996 Former President Jiang Zemin led a state delegation to Africa, which marked the beginning of China's renewed interest in African countries. The visit set a precedent for China's new approach to its foreign relations with Africa. The newly democratic South Africa established official diplomatic relations with China two years later, in 1998. The increasing proactive Sino-Africa deliberation subsequently led to the launch of the Forum on China-Africa Cooperation (FOCAC) in 2000. The ministerial FOCAC meetings are scheduled to convene every three years,[47] and have become an important platform for African and Chinese leaders, businesses and civil society to engage with one another and configure economic plans and development programmes (Vines 2006: 67). Once Hu Jintao became President in 2002, his administration placed emphasis on building political capital with other developing countries, particularly those in Africa. FOCAC has accentuated dialogue between China and Africa, as well as facilitated trade and cooperation.

Due to the country's diminishing mineral reserves and rising industrialisation, China's new foreign policy orientation on Africa is part of its quest to secure to secure new energy supplies and raw materials. In return China has offered African countries economic aid, interest-free loans, technical assistance and preferential credits. Chinese parastatals have been deployed throughout the continent to build government buildings, highways, hospitals, schools, sports stadiums and waterworks (Africa Research Bulletin 2006: 17000). Furthermore, at the 2003 FOCAC meeting in Addis-Ababa – Ethiopia – Chinese Premier Wen Jiabao announced that China had cancelled the debt of 31 African countries, to the sum of US$1.3 billion. During the following year China invested nearly US$1.2 billion in Africa, of which US$200 million went to South Africa (White & Alves 2006: 59). The rise of Chinese investment in South Africa is concurrent with increasing trade between China and SACU. In spite of Swaziland not having diplomatic relations with the PRC, South Africa's then Deputy President Jacob Zuma announced in 2004 that SACU would consider negotiating an FTA with the PRC.

China's first African Policy Paper was issued in January 2006, articulating the objectives of the country's policy towards Africa. Part of this new policy is China's intention to

[47] The first FOCAC Ministerial meeting was held in Beijing, in 2000. The second Ministerial Meeting was held in Addis Ababa in 2003. The most recent FOCAC Ministerial Meeting was held in 2006, in Beijing.

negotiate an FTA with key African countries and regional trade blocs. In an effort to cement a new strategic partnership with Africa, the paper emphasises key terms – i.e. 'common development', 'mutual benefit' and 'win-win' results in the relationship. The fast growing economic ties between China and Africa was highlighted at the most recent FOCAC Summit that was held in Beijing in November 2006 and at the Annual Board Meeting of the African Development Bank (AfDB) that was held in Shanghai in May 2007. The FOCAC Summit was attended by 41 African Heads of State and 7 other high-profile government officers. The African leaders and the Chinese government adopted a sector-specific Beijing Plan of Action for the period 2007 – 2009, which involves a multi-billion dollar development package[48] (FOCAC 2006: Internet; Orr 2006: 6; Wang 2007: 4 & 12).

China's engagement with African countries has, however, been subject to criticism and debate. London-based human rights watchdog, Amnesty International, has accused China of fuelling conflict and human rights violations in Sudan and Zimbabwe by stocking up the arsenals of their alleged repressive governments. This form of trade has seemingly been considered an endorsement of the political leadership in the two above-mentioned countries, which the majority of the international community has denounced (Africa Research Bulletin 2006: 17000). In response, China maintains that its relations with African countries are based on mutual benefit and non-interference in the domestic affairs of sovereign states.

In response to the West's criticism of China's engagement with African countries, in 2006 China published its first policy document for Africa, which stated the following:

> China will unswervingly carry forward the tradition of China-Africa friendship proceeding from the fundamental interests of both the Chinese and African peoples, establish and develop a new type of strategic partnership with Africa, featuring political equality and mutual trust, economic win-win co-operation and cultural exchange. (Vines 2006: 68).

[48] In the package China has pledges the following: US$ 3billion in preferential loans and US4 2billion in preferential buyer's credit; the doubling of its 2006 aid assistance by 2009; initiating a US$ 5billion China-Africa development fund; increasing preferential terms of trade for 440 products; training 15,000 Africa professionals; the establishment of ten agricultural technology demonstration centres; the construction of 30 hospitals and 100 rural schools; US$ 37.5million grant to combat malaria; the dispatching of 100 senior agricultural experts; doubling the number of Chinese government funded scholarships for Africans to study in China from 2,000 to 4,000 by 2009 (FOCAC 2006: Internet).

However, critics claim the interests are selfish and perversely focused on energy sources and minerals. During the early 1990s China shifted from being a petroleum exporting country to now being a net importer of petroleum – consuming 5.46 million barrels a day (Alden 2005: 138). Developing relations with oil-producing countries is thus understandable, but the argument is flawed when applied to Southern Africa. Does the region have less to offer, especially in light of the energy crisis in South Africa (the region's main energy exporter) and the lack of oil reserves in the SACU countries? What is driving the levels of accelerated economic relations and trade between China and SACU?

During the Chinese Premier Wen Jiabao's two-day visit to South Africa in June 2006, the two countries discussed nuclear power, textile imports and regional alliances. The high-profile diplomatic meeting failed to materialise a definitive and legally binding agreement, since the respective leaders only managed to sign political understanding documents – as such memorandums of understanding (MOU) (Africa Research Bulletin 2006: 17000). The same disposition was taken a year later during Chinese President Hu Jintao's visit to South Africa in February 2007. The two leaders signed protocols on phyto-sanitary requirements for agricultural exports, an MOU for cooperation in the Mineral and Energy Sector, and an agreement on Economic and Technical Cooperation (DFA 2007: Internet). This stance demonstrates caution from both parties who seek to enhance economic diplomacy, yet without disconcerting their respective domestic industries. Hence, the MOUs carry no measure to monitor any restraint. South Africa's signing of MOUs with China sets a precedent for BLNS countries, some of which have allegedly held their own meetings with the Chinese government.

From the MOUs, one may reason that South Africa recognises a need to protect its domestic industry from China, as well as perhaps that of the region. However, only the official negotiations will reveal if/how this acknowledgment of market protectionism will be reflected in a potential trade agreement. McCarthy (2008: 13) claims that even though political forces may drive regional integration agreements (RIAs), which was the case for SACU, the regional integration remains an economic construction. As such, the member states would inevitably and ultimately expect economic returns from the RIA. In SACU, for instance, the BLNS countries share significant earnings from the CRP while South Africa has a devoted market for its exports. However, this analogy is not exclusive to RIAs, as it generally applies to all bilateral relations irrespective of geographic location. Therefore, although there is interest for a SACU-China FTA at a political level, is it justified by a likely scenario of greater long-term economic returns for the SACU region? Would the returns compensate the collateral loss in customs revenue?

4.5 Conclusion

The Southern African Customs Union is a highly integrated and the most advanced regional organisation in sub-Sahara Africa. Although it is the world's oldest customs union, its complex history makes it an unsuitable model for regionalisation between sovereign states. SACU was forged during the colonial era with a unanimous understanding that the HTCs would become part of the Union of South Africa. In that view, the endorsement of the customs union was merely a preparatory requirement for integrating the economic and trade policies of separate 'constituencies' for the envisioned single nation state to be governed from Pretoria. As a result, programmes for industrialisation and development focused primarily on South Africa. The role of the HTCs, in this regard, was generally to exist as a market for South African goods and to supply South Africa with dispensable human resources. Accordingly, nearly all of the imports going into the HTCs were obtained from South Africa. Furthermore, a significant amount of the male labour force of the HTCs worked underground in South African mines. There are specific features about the relationship between South Africa and the HTCs, analysed in this chapter, which demonstrate the conception of a dependence on South Africa. Once the HTCs became politically independent, their economic dependence became more noticeable and instantaneously recognised as a detriment.

The 1969 SACU Agreement was a product of negotiation between independent states of the customs union. Botswana, Lesotho and Swaziland urged South Africa to reconsider certain policies that were dissuading investment and industrial development in their countries. One means of compensating the BLS countries for the legacy of skewed distribution of wealth in the region was to renegotiate the Common Revenue Pool, from which customs duties would be redistributed using a revenue-sharing formula managed by the South African Reserve Bank. With time, the BLS countries become increasingly despondent about SACU's lack of an autonomous decision-making and regulating authority. However, it was only after the emancipation of South Africa in 1994 could the respective states renegotiate the terms of SACU for a more democratic system. With Namibia, as a new party, the five members subsequently signed the 2002 SACU Agreement at the SACU secretariat in Gaborone.

With clear administrative institutions, SACU is in a better position to negotiate a bilateral trade agreement with China. However, prior to such an attempt it is pivotal that SACU meticulously understands the implications of a possible new trade agreement with the particular second party. This chapter has identified three key characteristics of the economies of SACU that could determine the feasibility of engaging in free trade with China. First, South Africa dominates the geopolitics, the industry and the economy of the region. Its hegemony is symptomatic of SACU's history, and as such is a source for tension that must be diplomatically managed with delicacy. Second, Lesotho and Swaziland are small land-locked states that are heavily dependent on South Africa. Their currencies are pegged to the South African rand, they rely on SACU's Common Revenue Pool to subsidise their weak economies. Third, Botswana's economy is built on a mining industry that experts forewarn may soon be dissolute. The potentially devastating socio-economic impact of no diamond industry in Botswana highlights the importance of industrial diversification. A common thread in the three above-mentioned key characteristics is vulnerabilities, which if not addressed could potentially be aggravated by a free trade agreement with China.

China is recognised as an emerging market that has become a prime destination for foreign investment but also as a significant hub for manufacturing products. Although the BLNS countries endeavoured to engage with China during the 20th century, it was only since South Africa and China officially launched their diplomatic relations in 1998 that one may notice accelerated economic and trade relations between SACU and China. This trend has raised suspicion and interest, amongst scholars as well as economists, about the feasibility of a SACU-China FTA. The two parties certainly have much to gain from one another, either by means of absolute advantage or comparative advantage. However, does SACU have a sufficient competitive advantage to engage with China under an FTA without neutralising its own efforts for regional industrialisation? Although both parties are interested in an FTA, it is in the interest of the SACU states to formulate a consolidated framework/position prior to commencing the bilateral negotiations. For the moment, an examination of the SACU-China trade profile is required to assess the sustainability thereof and its benefits to the SACU region. A comprehensive account of this is provided in Chapter 5. The impact assessment study will make use of parallel variables from the experiences of Mexico in NAFTA and that of South Africa in the TDCA.

CHAPTER 5

THE SACU-CHINA TRADE PROFILE: THE IMPLICATIONS OF an FTA FOR THE SACU REGION

5.1 Introduction

A good number of countries and regional organisations are increasingly opting to negotiate free trade agreements (FTA) with second and third parties, especially considering the terms currently being negotiated in the World Trade Organisation's Doha-round. In the case of the Southern African Customs Union (SACU), the regional organisation has already signed FTAs with the European Union (SACU-EFTA) and with a Latin American trade bloc (SACU-MERCOSUR). Even though these agreements are still to be incorporated into the domestic policies of the SACU countries, SACU is already considering negotiating FTAs with two other countries – i.e. China and India. In June 2004, South Africa and China issued a communiqué announcing their commitments to bilateral cooperation, which famously included their intention to negotiate a SACU-China free trade agreement. The actual negotiations may not have yet begun yet, but even so the mere prospect thereof will have considerable implications for the region.

It is the objective of this chapter to examine the implications of a possible FTA between SACU and China on the SACU region and its industries. Notably, in order to commence, knowledge of SACU's socio-economy is required, as well as that of the People's Republic of China. This is necessary in order to review how a potential FTA between the two parties could likely affect the SACU region. The first part of the chapter thus provides an analysis of SACU industries, which are the main source of labour in the region. This is followed by a review of China in the global economy. As the new global manufacturing hub, China sets the benchmark for the global prices of low-cost goods. Therefore a review of the implications of China's new role in the international political economy is necessary, as well as a scrutiny of China's interest in Africa – predominantly focussing on the SACU region.

The gradual increase in the scale of trade between SACU and China is widely reported. This chapter explores various aspects related to the current trade profile between SACU and China, i.e. SACU's main import products from China and main export products to China. Initially the increase in trade was naively viewed positively at a diplomatic level by the respective governments. There are several features about SACU's bilateral relations with China that are uncharacteristic of developing countries moving towards FTAs. For instance, although China is a major trading partner for SACU, the same cannot be said about SACU's importance to China when quantified in economic terms. Furthermore, the current trend of export products destined for China and import products entering SACU raises several concerns. Although both parties are classified as developing countries of the world, it will be shown ahead that in relation to China, SACU finds itself back in the primary industry and commodity trade trap that many African countries are accustomed to with the West.

Since free trade agreements are not narrowly focused on trade alone, this chapter also reviews the type of foreign direct investments made by both parties in the respective countries. Here Adam Smith's theory of comparative advantage is more suitably put to use, as the types of investment differ in magnitude, expertise, research and development, and market share. Chinese investments are classified in two tiers. Major capital investments have been made in the automotive sector, in mining and in information and communication technology (ICT). Wholesale, retail and Chinese restaurants are classified as smaller investments. Although the impact of increased trade with China differs across sectors and member countries in SACU, both parties should not fail to recognise certain discrepancies. For instance, the ramifications of importing cheap Chinese textiles, clothing and footwear (TCF) provides remarkable insight on how SACU is to negotiate and manage all current and future terms of trade with China.

There are many contending and sometimes contradicting assertions about the trade balance between African countries and China. Trade unions and critics are especially concerned about its sustainability and the looming implications for the continent. This chapter demonstrates how the ambiguities emerge in SACU – a regional organisation whose largest economy is far greater than the remaining four member states. In the event of an FTA, three possible futures are proposed. First, SACU could have greater access to the Chinese market, but the increased trade with China would merely manifest itself as trade diversion. Although trade diversion may satisfy political diplomacy, the quantitative gain thereof for the region's socio-economy is trivial. Second, the tariff-free importation of cheap consumer goods from China may benefit consumers in SACU, but not the region's labour force. It would inhibit SACU from developing a competitive domestic manufacturing sector for low-cost consumer goods. Third, although the quantity of trade may increase, the quality thereof will remain the same. Therefore a SACU-China FTA may perpetuate the current trade profile, which reflects a North-South model of trade. Generally, SACU exports primary commodities to China and imports manufactured consumer goods. There is minimal value-added to SACU's exports, yet its imports from China are sold directly to the end-consumer. Essentially, this chapter will raise several questions about the trade relations between SACU and China. Do both parties mutually benefit from the trade? Would an FTA be conducive to sustainable industrialisation in the SACU region?

5.2 The Socio-economy of SACU

5.2.1 SACU Industries and the Engines of Growth

The Southern African Customs Union is the deepest form of regional integration in Africa (Holden 1998: 467). It administers a consolidated external customs system and a sophisticated revenue-sharing mechanism to divide the proceeds thereof. Although Lesotho and Swaziland are heavily dependent on SACU customs earnings, they do have industries that generate an income. Figure 5.1 displays the GDP composition of the SACU countries – i.e. by percentage ratio according to agriculture, industry and services. As indicated in the table, SACU's total GDP in 2007 was US$ 510.922 billion, of which its largest contributors are the service sector and industry at 51 percent and 40 percent respectively. Agriculture contributes a mere 8 percent to the region's GDP. Mining and mineral products, which are a significant source of income for Botswana and South Africa, form part of the industry sector (see Chapter 4).

In the previous chapter key characteristics of the SACU region were examined, including the political and socio-economic hegemony of South Africa in the customs union. South Africa, being the manufacturing hub of the region, has the strongest economy of the SACU countries. Its GDP accounts for nearly 92 percent of the region's gross domestic product (see Figure 5.1) Furthermore, SACU's GDP composition shows that an aggregate of 51.68 percent of the region's GDP is generated from the service sector – one which is almost entirely reliant on domestic consumer buying power and on foreign tourists. South Africa's service sector contributes the most to the region's GDP (70.9 percent) compared to the BLNS service sectors as well as compared to the contributions of the agricultural sector and industry sectors across the SACU region. Although South Africa's industrial sector is the smallest of SACU countries to contribute to its national GDP (only 27 percent), it remains the strongest in real terms (US$126.252 billion) and even outweighs the sum of the BLNS GDP. Similarly, South Africa's agricultural sector is also a small factor to its GDP (only 2.2 percent), but one which is still high in real terms (US$10.287 billion).

Figure 5.1: The GDP Composition of SACU Countries in 2007

SACU Countries	GDP (PPP)- US$	Agriculture	Industry	Services
South Africa	467.600 billion	2.20%	27%	70.90%
Botswana	24.140 billion	1.60%	51.50%	46.90%
Lesotho	3.088 billion	15.20%	45%	39.70%
Namibia	10.670 billion	10.60%	30.80%	58.60%
Swaziland	5.424 billion	11.80%	45.80%	42.30%
SACU	510.922 billion	8.28%	40.02%	51.68%

Source: Author's calculations from CIA World Factbook (2008a, 2008c, 2008d, 2008e, 2008f: Internet)

Botswana's industrial sector makes the largest contribution to its country's GDP (51.5 percent), of which over half of the income is generated from the mining sector. Botswana certainly has one of the most impressive diamond mining industries in the world. However, records of its diminishing reserves are a clear indication of the country's need to diversify its economy and its industrial sector (see Chapter 4). Economic diversification is not an issue only known to Botswana; it is a regional issue in SACU as well as in the rest of Africa.

The agricultural sector in SACU clearly contributes the least to the region's GDP, a low aggregate of 8.28 percent. This observation is noted for future reference; it is especially relevant for the assessment of possible trade opportunities for SACU in the event of an FTA with China, i.e. SACU's agricultural exports have the potential of gaining considerable market share in China and trading more competitively with produce from other countries. Lesotho and Swaziland contribute the least to the region's GDP. As displayed in Figure 5.2, they both have marginal industries and agricultural sectors. As per the initial intention of the Union of South Africa, examined in Chapter 3, these two counties serve the region with *de jure* export markets for South African goods and supply the region with cheap dispensable labour.

Figure 5.2: Outline of SACU Members' Industries and Agricultural Products

SACU Countries	Industries	Agricultural Products
South Africa	Mining (chromium, diamonds, gold and platinum), automobile assembly, commercial ship repair, metalworking, iron and steel, machinery, textiles, chemicals, fertilizers and foodstuffs.	Corn, sugarcane, wheat, vegetables; beef, poultry, mutton, wool, dairy products
Botswana	Diamonds, copper, nickel, salt, soda ash, potash; livestock processing; textiles	Livestock, millet, maize, beans, sunflowers, groundnuts
Lesotho	Food, beverages, textiles, apparel assembly, handicrafts, tourism	Livestock, millet, maize, wheat, pulses, barley
Namibia	Fish and livestock processing, dairy products; mining -copper, diamond, lead, tin, sliver, zinc, tungsten, uranium	Livestock, fish; millet, peanuts, grapes
Swaziland	Coal, textiles and apparel, wood pulp, sugar, soft drink concentrates	Cotton, corn, sugarcane, tobacco, rice, citrus, pineapples, peanuts, livestock

Source: CIA World Factbook (2008a; 2008c; 2008d; 2008e; 2008f: Internet)

Figures 5.1 and 5.2 demonstrate that the SACU countries not only vary in size, but their economies also differ in composition. Furthermore, Figure 5.2 illustrates that South Africa has the most sophisticated economy, from which manufactured products contribute substantially more to the country's export earnings. On the contrary, the BLNS countries produce and export mostly primary goods. In general terms, Botswana's main export product is diamonds, Namibia's is beef, and Swaziland's is sugar. Due to Lesotho's lack of scalable primary resources, the country manufactures mostly textiles and garments that are exported to the USA as part of the African Growth and

Opportunity Act (AGOA)[49] (Meyn 2003: 2). However, in theory, it is industry that forms the backbone of an economy. In SACU, industry is concentrated in South Africa. The organisation does have a highly integrated and functioning customs union system, but lacks a regional industrialisation strategy (see Figure 5.3). The absence thereof means that the member states do not share common interests during SACU's trade negotiations with third parties. Therefore, an FTA with an external party that does not benefit all SACU members may actually cause further divergence and threaten the region's political stability.

Figure 5.3: SWOT Analysis of SACU Industries and Engine of Growth

STRENGHTS	OPPORTUNITIES
• Integrated customs union system • Rich in mineral resources • Sound and regulated business environment	• Untapped markets in BLNS economies • Capital investment from FDI • Abundant supply of unskilled (cheap) labour
WEAKNESSES	**THREATS**
• No regional industrialisation strategy • Weak project management expertise • Insufficient human resource development • BLNS dependence on customs duties • Non-representative trade negotiations	• Brain drain and emigration • Political instability • Over-active labour unions • FTAs curb rate of technology transfer and skills development

Source: Author's analysis

Theories surrounding economic nationalism claim that countries produce more goods than they require (for export purposes), but they are also less inclined to import consumer goods in order to support local industries and new industrial development (Salvatore 1987: 14). In the absence of tariffs and quotas parties engage in free trade. Considering the above cited SWOT analysis of SACU, if all trade barriers were to be removed from all trade with China, what would its impact be on the region? It was David Ricardo who suggested that each state should specialise in producing and exporting the commodity for which it has the smallest absolute disadvantage. Similarly each state should also import the commodities for which it has the greatest absolute

[49] AGOA, which was signed in 2000, is a preferential trade agreement that awards Africa's least developed countries (LDCs) to export more than 6,400 items to the USA under preferential quota and duty-free terms (AGOA Internet: 2008).

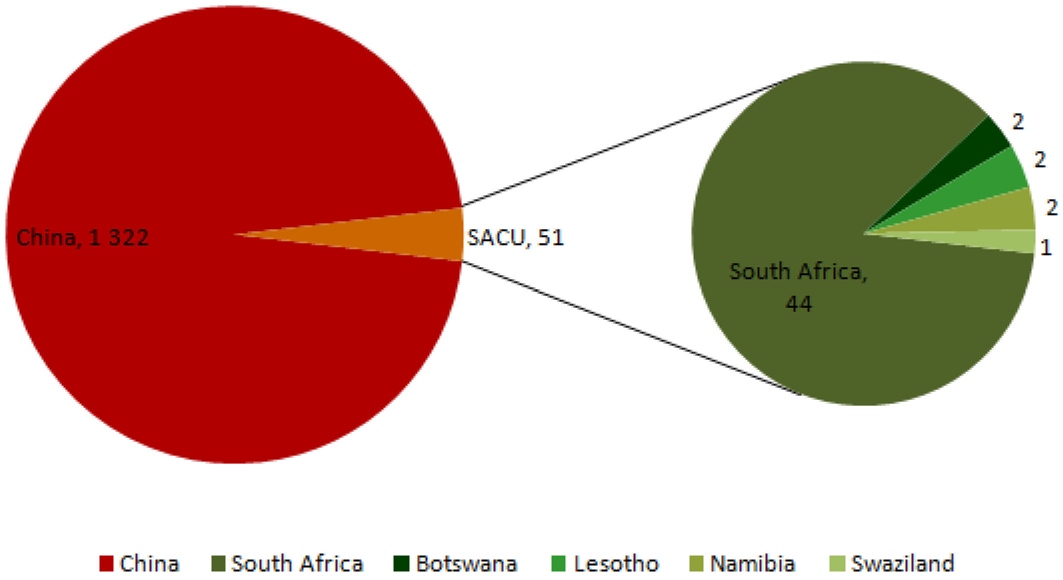
disadvantage (Salvatore 1987: 18). Bearing this in mind, in the following section the trade profiles of SACU and China are examined. However, in this critical analysis of SACU's socio-economy one must also review SACU's human resources and factors hindering socio-economic development.

5.2.2 Human Resources and Socio-economic Development Issues

The SACU region is faced with socio-economic issues that compromise the member states' efforts to consolidate sustainable development, i.e. regional imbalances, a growing income disparity between the rich and the poor, rural underdevelopment, urbanisation, labour migration, human resources, HIV/AIDS, population growth as well as developing a substantial domestic market that will be competitively integrated in the international community (Yang 2006: 30). According to the World Bank (2003: 1 - 3), the high prevalence of the HIV/AIDS in the region has compounded SACU's development challenges. It has a crippling effect on the productivity of industries and causes household instability. The life expectancy in the region has decreased from 51.6 years in 1997 to an estimated 41.6 in 2007 (CIA World Factbook 2008: Internet). The United Nations Development Programme (UNDP) uses these factors, amongst others, as variables of a formula that is used to rank countries on its *Human Development Index* (HDI). In the recent 2007/2008 HDI ranking, the SACU countries are classified as developing countries under the 'Medium Human Development Category' in the following positions: South Africa 121, Botswana 124, Namibia 125, Lesotho 138 and Swaziland 141. Interestingly, China is also included in the same category at number 81 (UNDP 2008: Internet). Despite this same categorisation, the comparative analyses of certain variables that are examined below reveal their dissimilarities.

Figure 5.4 illustrates that China's population size is nearly 26 times that of the sum of SACU countries, which is approximately 51 million (CIA World Factbook 2008a-f: Internet). In economics the population size of a country and/or a region is often used as an indicator of the size of the consumer market. Since the size of the SACU market is miniscule compared to that of China, in theory the prevalence of Chinese exports to SACU would have a far greater impact on the region than vice-versa. The purpose of examining SACU's human resources and socio-economic development issues is therefore to highlight certain variables in the region that would affect and be affected by an FTA between SACU and China – i.e. the labour force, unemployment, and the plight of HIV/AIDS as a threat to human security in the region.

Figure 5.4: Comparative Population Sizing (Million)

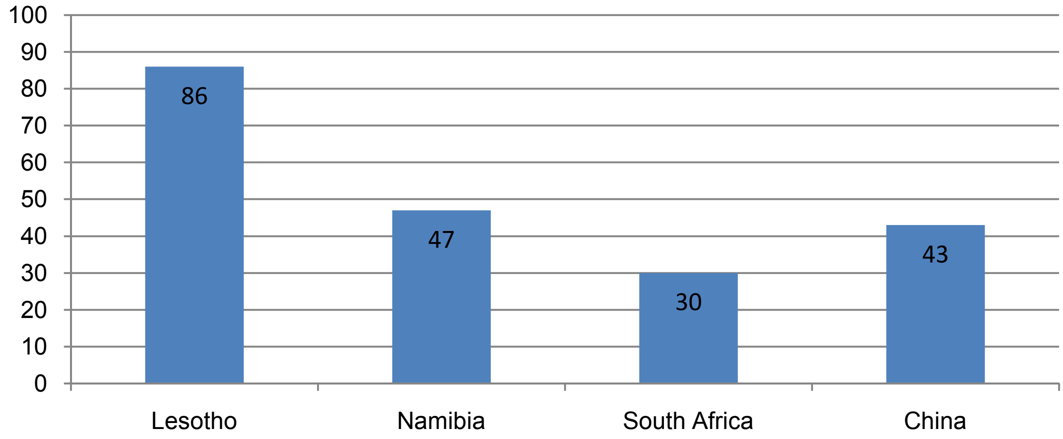


Source: CIA World Factbook (2008a-f: Internet)

Agriculture is of significant importance in the SACU region. Although it contributes the least to the national GDP figures of the member states, agriculture is the region's main source of employment. It would thus be reassuring if China's interest in African countries extends far beyond commodities and raw materials. South Africa, for instance, is the world's third largest exporter of citrus produce. Although SA's citrus industry is globally competitive, very little of its product enters the Chinese market. SA citrus exports are taxed an average of 12 percent in China. Australia, which is SA's only significant competitor for citrus products in China, is already engaged in FTA negotiations with the Chinese government (Mandigora 2006b: Internet). To improve SA's market share and competitiveness in the Chinese market, SACU may need to consider liberalising trade between both parties – particularly in this sector.

Figure 5.5 displays a comparative account of the agricultural sector's contribution the labour force in SACU compared to China. Lesotho's economy is heavily dependent on the subsistence farming of agricultural products and livestock. As displayed in Figure 5.5, the agricultural sector accounts for 86 percent of the country's labour force. Lesotho has an unemployment rate of 45 percent and nearly half of its population live below the poverty line – on less than US$1 per day. Nearly 20 000 migrant workers, previously employed in South African mines, return to Lesotho each year seeking new employment.

Figure 5.5: Percentage of Labour Force in Agricultural Sector



Source: CIA World Factbook (2008b, 2008c, 2008d, 2008e: Internet)

The socio-economic indicators of Lesotho are similar in Swaziland, where the unemployment rate is 40 percent and nearly 69 percent of the population live below the poverty line. Approximately 60 percent of the land-locked country is used for arable farming, which has stimulated pockets of agro-processing factories around the country (CIA World Factbook 2008c, 2008f: Internet; Nepad Business Group 2003: 169-170). Nonetheless, the agricultural sector is still not producing enough for domestic food security, let alone for an export market. Commercialising farming practices would add value to the products, thereby maximising profitability.

Botswana and South Africa have the smallest unemployment rates in SACU, 23.8 percent and 24.2 percent respectively. Both their unemployment ratios are the same – i.e. for every single employed member of either country's population there are four people who are unemployed. Interestingly, according to Figure 5.6, China also has the same 1:4 ratio of unemployment. With not much of an industrial sector, Namibia's unemployment rate is 37 percent; nearly 35 percent of the country's population live below the poverty line. As one of the world's most arid countries, the economy of this sparsely populated country is based on mining, fishing, agriculture and tourism (Nepad Business Group 2003: 210 & 263).

As illustrated in Figure 5.6, SACU and China face similar socio-economic challenges especially related to unemployment. Therefore, in principle, if trade creation could offer new avenues of employment, both parties should find an FTA mutually beneficial. The three possible futures examined later in the chapter elaborate on the subject. In the interim, note that irrespective of the parallel ratios of unemployment between the two parties, in real terms SACU's entire population is still far less than the number of unemployed people in China. Therefore, any negative effect on SACU's productive labour force would have far greater socio-economic repercussions on the region than would be the case in China.

Figure 5.6: Ratio of Unemployment Between SACU and China

Area	Population	Labour Force	Unemployment (%)	Unemployed People	Unemployment Ratio
RSA	44 Million	20.5 Million	24.2	10.6 Million	1:4
Botswana	2 Million	288 400	23.8	0.5 Million	1:4
Lesotho	2 Million	838 000	45	0.9 Million	1:2
Namibia	2 Million	660 000	37	0.7 Million	1:3
Swaziland	1 Million	300 000	40	0.4 Million	1:2
SACU	51 Million	22.6 Million	34	17.3 Million	1:3
China	1, 3 Billion	803.3 Million	24.3	321.2 Million	1:4

Source: Author's analysis from CIA World Factbook (2008a-f: Internet)

5.3 The People's Republic of China

5.3.1 The Global Manufacturing Hub

On the back of an impressive economic growth rate, China finds itself being ranked amongst the world's largest economies. China's political influence in the international community is long-standing, especially since it gained a permanent seat on the United Nation's Security Council in 1972. China's growing economy has been marked by an unprecedented record of augmenting contributions to world trade. Its geopolitical importance to the world has thus increased dramatically since the end of the Cold War. In the aftermath of the 2008 global economic crisis, China is assuming a new role as the world's financial leader. Its challenging of the authority of the US Dollar is eroding faith in the western principles of capitalism and is discrediting the Washington Consensus on how developing countries should manage their economies – replacing it with a 'Beijing Consensus' (Cha 2009: Internet).

China has become an "alternate centre of power in an otherwise unilateral post-cold war world order" (Naidu 2005:457-458). Therefore, opening up to China politically is a necessity. However, opening up one's market to its economy should be done cautiously. Chinese firms are increasingly establishing fixed operations in foreign markets, gaining off-shore market share and becoming more multinational (Davies 2005: 154-156). In Africa, as well as specifically in the SACU region, China has become a major foreign investor (see section 5.5). However, the SWOT analysis of SACU revealed that in spite of having a regulated business environment,[50] SACU still lacks a regional industrialisation strategy. Further market liberalisation, amid increased Chinese FDI in the region, could limit SACU's policy choices if/when the need arises to protect the regional market from foreign competition.

Irrespective of the language barrier and unfamiliarity with domestic laws ad regulations, China is luring foreign investors with FDI incentive schemes, low labour costs and a sound environment for business. In 1994 it was the world's third-largest recipient of foreign direct investment (FDI), US$ 60 billion. In comparison, annually, Brazil attracts an average of US$ 20 billion and South Africa attracts less than US$ 1 billion (White & Alves 2006: 58). Two years later, China became the second-largest recipient of FDI in the world.

As a net importer of raw materials and natural resources, China has also gradually begun to set the global prices for commodities. Furthermore, considering its abundant and low-cost production of goods, China has begun to set the standard global prices for manufactured goods (Alves 2006: 5). This means that China has become the *de facto* measure of input and output products. The implication thereof on the SACU region, considering the low cost of raw material and low cost of Chinese manufactured goods, is that it reduces SACU's competitive advantage in the region and comparative advantage in the global market.

50 See Figure 5.3 on SWOT Analysis of SACU Industries and Engine of Growth

China's integration into the international community since the 1980s has had a remarkable effect on global trade. Due to the exceptionally low cost of labour in China, several multinational corporations (MNCs) have relocated their manufacturing operations to Chinese export processing zones. This is increasing China's share in global trade, as input products are shipped to China for processing. Subsequently, semi-processed and/or processed goods are increasingly exported directly to their final export destinations from China and not to the country of origin of the investing MNC. Industry experts claim that China's share of the global manufacturing output could increase from its current 7 percent to nearly 25 percent by 2025 (Davies 2005:154). According to Alves (2006: 5), this dynamic has an unprecedented impact on the global division of labour. At present the exports from the global north have been focused on capital-intensive products, while the global south has focused on labour-intensive products. China has become a labour-intensive and increasingly a capital-intensive player in the global trade system. As the world's new manufacturing hub, it may be averting FDI from alternative markets.

Although the majority of China's exports are destined for the USA and the European Union (EU), African countries have become a notable target market for Chinese goods and services. Furthermore, China's development requires a profuse supply of mineral and energy supplies to fuel its economy (Yang 2006: 26), hence the growing number of Chinese investments in extractive industries around the African continent. The Chinese economy is an undisputed emerging powerhouse in the East. As the emerging global manufacturing hub, export markets are required to absorb its mass production and input products are needed to fuel the economy. As such, China's growing interest in Africa (including the SACU region) has become a topical point of discussion.

5.3.2 Questioning China's Interest in Africa

There is much rhetoric by politicians of how China and Africa have overcome their parallel colonial past and continue to experience similar political and socio-economic challenges. Perhaps it is for this reason that African countries treat Chinese investors with less suspicion, which is often still the case for Western firms. As for China, it views Africa as an important part of South-South cooperation. Both parties have a common interest in developing their economies sustainably in a manner that upholds their national sovereignty and maintains international peace and security (Yang 2006: 23). However, critics claim that African countries have much to be weary of when it comes to China. This sentiment is heightened when one bears in mind its highly contentious relations with the governments of Angola, Sudan and Zimbabwe. Although Angola, Sudan and Zimbabwe fall beyond the scope of this paper, suffice it to mention a few details to explain the West's disapproval of China's relations with the governments of these three African countries.

In Sudan and Zimbabwe, China has supplied the respective governments with large arms shipments as well as fighter aircrafts. This is amid social instability in both countries – i.e. allegations of genocide by government supported insurgents in Sudan's Darfur region, and the alleged dictatorial regime of Zimbabwean President Robert Mugabe (Moorcraft 2007: Internet). China has even used its veto power in the UN Security Council to block the organisation from imposing sanctions on Sudan (Naidu 2005: 477).

In each of the three above-mentioned African countries China has provided financial and political support to their respective governments without probing governance issues and their supposed grave violations of human rights. To date these have been routine criteria of engagement by Western counterparts, hence the West's expectation of China to do the same. Yet, China prefers to adopt a rather pragmatic approach to engaging with African countries, one that is predisposed to a policy of non-interference and respect for national sovereignty (Le Pere & Shelton 2006: 35).

Circumstances between China and the above mentioned African countries (Angola, Sudan and Zimbabwe) are amongst the most controversial cases of Chinese engagement on the continent. Furthermore, a central element that has been the subject of much debate is China's alleged narrow focus on the extractive industry – i.e. mining, oil and gas. According to Sidiropoulos (2006: 105 - 106), managing China's involvement in this field is one of the greatest challenges to African countries. Over a period of time natural resources generate an enormous revenue stream, but once exhausted many countries often fail to recover from the depleting reserves. This thus raises questions on the sustainability of Chinese FDI, especially if it is narrowly focused on extractive industries. However, Africa is not homogenous and thus the target of Chinese investment differs, which is without a doubt the case in the SACU region.

In comparison to the rest of the continent, the SACU region has a more sophisticated infrastructure and a highly regulated business environment. Chinese MNCs operating in SACU face different operational dynamics and thus play a different role in the region. Examples of Chinese MNC investments in the SACU region are provided below. Suffice to mention here, that Chinese investments in SACU are more diversified and so not predominantly focused on extractive industries.

China's foreign policy towards Africa promotes a parallel footing in global politics, one which has shifted away from offering humanitarian aid to selected African countries to now providing official loans, subsidised interest rates, technical assistance and promoting collaborative joint ventures between China and African companies (Africa Research Bulletin 2006: 17000; Le Pere & Shelton 2006: 35). Over the last half century the West has offered African countries more than US$ 1 Trillion worth of aid, yet conditions in African countries have degenerated compared to the rest of the developing world. China thus noted that there is simply no correlation between aid and economic growth. African countries have also come to the same conclusion and note there is a need to attract sufficient FDI that will exceed the amount of annual capital flight (Moorcraft 2007: Internet).

A factor the world seems to overlook is that despite its unprecedented growth and impressive GDP (in comparison to African and Western economies), China is a relatively poor country when assessed according to its US$ 5,300 GDP per capita (compared to South Africa's US$ 10,000 GDP per capita). In retrospect, it is thus no surprise that China has in the past lost open tender projects to more experienced and capable competitors. Nonetheless, China is not disinclined to invest in fragile African economies that Western firms typically shy away from. China is less risk-adverse than Western firms when engaging with African economies. Since the majority of Chinese firms investing in Africa are state-owned enterprises, they adopt a long-term view on their investment returns (Vines 2006: 63).

Trade is not a zero-sum game when it comes to China and the SACU region. Evidence of the skills shortage and the need for trained and experienced professionals has already been established. Therefore, one must recognise the mutual and complex interdependence between China and SACU. Chinese firms have technology and managerial skills; the SACU region has rich natural resources and an industrious agricultural sector (Le Pere & Shelton 2006: 36).

The Chinese government and its state owned enterprises (SOEs) do not impose stringent conditionality on their investment terms. They are also not vocal about the good governance and human rights records of their African host countries (Vines 2006: 63). Certain members of the international community and human rights watchdog organisations would prefer that states use these issues to guide diplomacy and trade, but China's response so far has been indifferent. Instead, demonstrative of China's position on the topic as well as on promoting African exports to China, in 2005 PRC President Hu Jintao announced that 190 products from Africa's least developed countries (LDCs)[51] would be granted tariff-free access to the Chinese market (Minson 2008a: 2; Liu 2004: Internet).

Critics claim that China adheres to the principle of extraversion, enabling African elites to use resources provided by China (an external actor) in order to preserve their authority and legitimise their posting (Clapham 2006: 3). Alden (2005: 140 - 141) refers to this phenomenon as symbolic diplomacy. For instance, Chinese firms built new offices for the foreign ministry in Uganda and houses of parliament in Mozambique. The Chinese government recognises the fact that the new government buildings provide African governments with real and tangible symbols of power. Clapham (2006: 3) argues it is for this reason that Chinese investors have been readily and widely welcomed into the economies of African countries, with very little or no reservations. The fact of the matter is that African countries and China face similar challenges pertaining to reform and social stability, modernising while maintaining cultural values, widespread poverty, and elevating the per capita standard of living (Yang 2006: 23).

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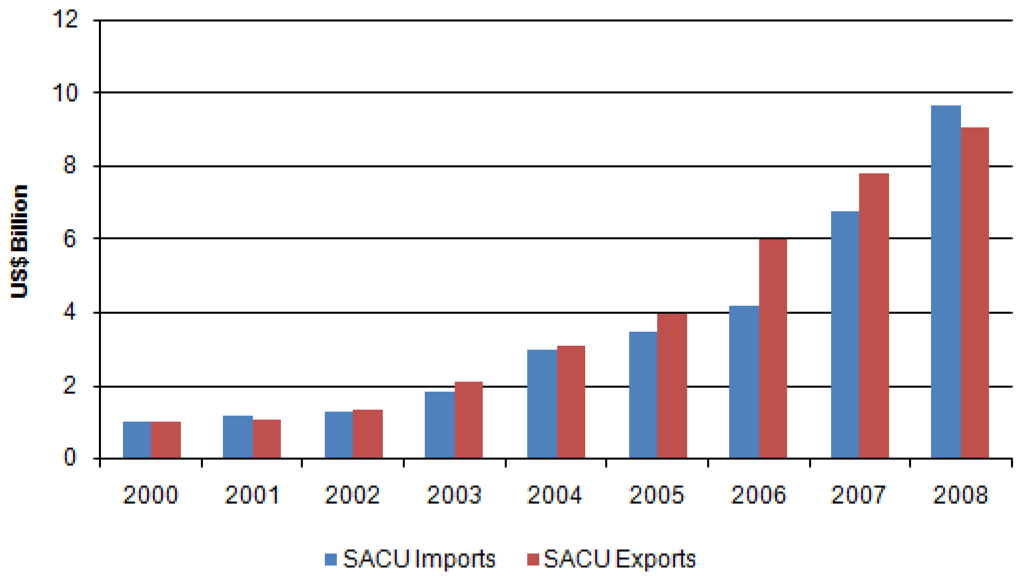
[51] According to the United Nations, the world's LDCs are those that exhibit the lowest indicators of socio-economic development and have the lowest Human Development Index (HDI) ratings. Of the world's 49 LDCs, 33 of them are in Africa – i.e. Angola, Benin, Burkina Faso, Burundi, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, and Zambia.

5.4 The Balance of Trade Between SACU and China

Between 2000 and 2008 trade between SACU and China has grown exponentially, from US$ 2.08 billion in 2000 to US$ 18.76 billion in 2008. On account of growth in trade, illustrated in Figure 5.6, one must examine the profile of the trade to evaluate its sustainability and impact on the region. It is the quality of SACU-China trade that will define the premise for or against an FTA. To begin with, an analysis of SACU's exports to China is provided, followed by an examination of SACU's imports from China.

Figure 5.6: Outlook of SACU-China Trade from 2000 until 2008



Source: World Trade Atlas (2009)

5.4.1 SACU Exports to China

SACU's exports to China in 2008 amounted to US$ 9.08 billion. The main products exported to China are iron ores, manganese ores, chromium ores, platinum, diamonds, ferroalloys, stainless steel products, copper ores, and nickel (World Trade Atlas 2009). This makes the region a net supplier of raw materials and commodities to the Chinese market. In 2007 South Africa exported ZAR 28 billion[52] worth of goods to China,

[52] There are various allegations claiming that the import and export statistics of trade between SACU/SA and China are manipulated or tweaked, hence the statistics often differ according to source (Sandrey & Jensen 2007:1).

marking a 14 percent increase from the previous the year and ranked fourth on South Africa's list of top export markets. Yet, South Africa's relations with China are not as significant. In 2005, for instance, South Africa only accounted for 0.52 – 0.6 percent of China's total imports (DTI 2008: Internet; Jensen & Sandrey 2006: 2).

The minerals that South Africa exports to China are levied at an average tariff of 3.45 percent for entry into China. This means that an FTA would have only a marginal effect on the cost competitiveness of these SACU products in the Chinese market. Therefore the bearing of a SACU-China FTA would only benefit SACU if it removes trade barriers from scalable products that are currently taxed high tariffs. Motor vehicles and aircrafts, for instance, are taxed an average of 15 percent and 5 percent respectively. Since there is growing demand for these products in China, an FTA would make the SACU products more competitive in the Chinese market (Jensen & Sandrey 2006: 2; Mandigora 2006a: Internet).

The Chinese market is highly competitive, not only due to the low cost of production in China, but also since foreign companies have begun to occupy market share. On the global list of China's main trade partners, South Africa ranked twentieth in 2006. It only supplied 0.6 percent of the PRC's imports (Eurostat 2007: Internet). China's trade with the BLNS countries is similar in composition, but extremely marginal. Nonetheless, in 2008 China's bilateral trade volumes with Botswana, Lesotho and Namibia were to US$ 352 million, US$ 81 million, and US$ 527 million respectively (World Trade Atlas 2009). Since Swaziland does not have diplomatic relations with the PRC, no trade data is recorded.

Botswana's main exports to China are nickel ores and diamonds. Namibia's main exports are also minerals – i.e. chemical elements, copper, zinc, lead ores and manganese (World Trade Atlas 2009). Limited processing is done before export and market access for other products remains difficult. In principle Lesotho, as a LDC, should have far better market access than the remaining SACU countries. The PRC intends to expand its list of products that are exempt from tariffs, from 190 to 440 items, for 30 African LDCs. The date of implementation is to be announced before the 2009 FOCAC ministerial meeting (Minson 2008b: 6). Lesotho's main exports to China are wool, animal hair and electrical parts. In 2008 it earned a mere US$ 1.7 million and recorded a negative trade balance of US$ 78 million (World Trade Atlas 2009). Although early evidence of the economic impact of the trade preference is inconclusive, one must acknowledge Lesotho's limited export capacity.

5.4.2 SACU Imports from China

Although SACU imports from China predominantly enter the customs union through South African borders, they are freely routed to their various destinations in the customs union. SACU imports from China generally consist of manufactured products, high-technology goods, capital equipment, television sets, electronic goods, 'white goods', textile, clothing and footwear (TCF) and agricultural goods (Naidu 2005: 468, World Trade Atlas 2009). For the year 2007 South Africa's Department of Trade and Industry (DTI) reported that imports from China amounted to ZAR 60.29 billion, marking a 12 percent increase from the previous year. This figure made China South Africa's second largest import partner – supplying approximately 10 percent of the country's total imports. The EU may be South Africa's top trade partner at the moment, but not for long if there is a SACU-China FTA (CIA World Factbook 2008e: Internet; The DTI 2008: Internet).

It was after China became a member of the World Trade Organisation (WTO) in 2001, that South Africa granted the country market economy status.[53] According to WTO guidelines, all its members must grant China market economy status by 2015, hence why the EU and the USA are in no hurry and are rather leisurely adjusting their domestic industries first (Naidu 2005: 468). The repercussion for South Africa and the rest of SACU (by default) is that granting China 'market economy status' is a preferential treatment. To much regional criticism, this annuls certain WTO disclaimers that shield South Africa and the SACU region from economic dislocations that may occur by an unfit increase in Chinese imports.[54]

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[53] A market economy is defined as one in which the production costs of all goods and services are subject to the demand of market forces, devoid of state interventions such as price controls or subsidies (Davies 2005: 165).

[54] The WTO agreement condemns dumping in cases where it may cause material injury to the domestic industry of the importing country (WTO 2008: Internet).

For instance, the granting of market economy status makes it extremely difficult to report Chinese exporters on anti-dumping cases (White & Alves 2006: 57-58). This is because when comparing the price of Chinese products to the 'average' price of the respective products in SACU, the Chinese imports appear to undercut the existing 'market price' in SACU to such an extent that it may be considered product dumping. However, Chinese manufacturers are not exporting products at a price below the cost of production or a different price than the one they charge in the Chinese market (WTO 2008: Internet). Therefore, technically, no anti-dumping charges can be laid against China. Therefore, by granting China market economy status, the industries in SACU have no grounds to contest Chinese imports on the grounds of dumping.

Imported TCF products from China currently hold between 50 to 70 percent of the market share in SACU (Jensen & Sandrey 2006: 3; Sandrey 2006b: 3). In response to much contestation China offered a voluntary restraint on exporting TCF products to South Africa, which technically included SACU by default. The memorandum of understanding (MOU) was signed in August 2006. China had previously signed a similar MOU with the European Union (EU) in 2005. According to the South African Department of Trade and Industry (DTI) the agreement reached between China and South Africa included potential joint ventures with Chinese firms in the manufacturing of TCF products (Sandrey 2006b: 2). The joint ventures would stimulate industrial activity and provide a medium for technology transfer and skills development to make South African businesses more competitive in the global market. Although there has been no monitoring of this process, the DTI's Deputy Director-General, Iqbal Sharma, announced that South Africa would not sacrifice its "... strategic long-term trade and political relationship with China for a clothing and textiles industry that had failed to adjust to the demands of global competition" (quoted in Yang 2006: 31).

During mid-2006 South Africa did eventually place quotas on the importation of Chinese TCF products in order to protect its domestic industry. In 2007 China's TCF exports to South Africa dropped by 48 percent, from ZAR 7.15 billion to ZAR 3.71 million (Sandrey & Vickers 2008: 30). The use of tariff protection is a mercantilist principle intended to offer the domestic market with an incubating business environment for domestic industries to establish themselves. South Africa's introduction of trade barriers to Chinese TCF products demonstrates that it recognises the negative effect of

Chinese imports on the market, as well as the potential damage it could still have on the region. This position, therefore, also annuls the viability of a SACU-China FTA that annuals all trade barriers – eliminating quotas and reducing tariffs to zero.

The range of products that SACU imports from China in relation to its main export products to China raises certain concerns. In the event of an FTA, the volume of trade between both parties is forecast to increase. However, apart from an increase in trade, how else could a SACU-China FTA impact the region and what opportunities are there for SACU countries to invest in China?

5.5 SACU Countries' Investments in China

Perhaps with the exception of South Africa, according to Clapham (2006: 3), no country in Africa can begin to engage with China on the same scale that China is engaging African countries.[55] Although South Africa's economy is the largest one on the continent, it is trivial compared to that of China. Nonetheless, by the end of 2005 South African investments in China amounted to US$ 770 million, nearly three times that of China during the same period (Yang 2006: 29). This is ironic, considering China's economy is nearly 13 times bigger than that of SACU.[56]

South Africa, home to the region's corporate giants, only has some 20 companies based in China whereas there are over 200 Chinese companies based in the SACU region. South African investors in China are amongst the country's finest financial, mining and resources conglomerates. These include *Absa, Old Mutual, Standard Bank, Anglo-American, Anglo Gold, Anglo Platinum, Anglo Coal, Kumba Resources, Sasol, De Beers, MIH (M-Tel), Sappi*, and *SAB Miller* (Naidu 2005: 470 - 471).

The Gauteng Economic Development Agency (GEDA) has a virtual mining initiative with China for equipment procurement from GEDA suppliers. South Africa's Sasol Synfuels International signed a joint venture with Chinese firms *China Shenhua*

55 Trade between China and Angola amounted to US$25.3 billion in 2008. Angola's petroleum exports have made the country China's largest trade partner in Africa (Xinhua 2009: Internet). Even so, South African FDI in China exceeds that of Angola.

56 In 2007, SACU's total GDP was only US$ 510.922, compared to China's GDP was US$ 7.043 trillion.

Liquidification Company, *Ningxia Luneng Energy and High Chemistry Investment Group*. The consortium intends to establish coal-to-oil plants in the Shaanxi and Ningxia provinces of China (Naidu 2005: 471).

While China offers a more competitive manufacturing hub in the global market, SACU industries may not be able to compete in China without some form of state support – i.e. subsidies, preferential trade agreement, etc. Note that potential increase of SACU's FDI into China means that there will be less capital available to invest in SACU industries. Socialist and economic nationalist theories would find this move to be a negation of the region's development agenda. However, irrespective of cheaper productions costs in China, would SACU's prospective investors choose to make a business decision based on their corporate aspirations of capitalism or on the region's socio-economic needs? Perhaps the answer lies in ownership, where a distinction is made between state-owned enterprises and privately owned enterprises.

5.6 The Nature of Chinese Investment in SACU

5.6.1 Major Capital Investments

China's overseas investments have developed quite rapidly compared to that of other developing countries. The major capital investments are predominantly medium-sized agricultural enterprises, resource development companies and industrial enterprises (Wu & Chen 2001: 1252). In Africa, Chinese firms have also made significant headway in the information and communication technology (ICT) sector - e.g. *Huawei Technologies, Haier, ZTE, Lenovo HiSense, Sinotech* and *TCL*. *Huawei Technologies* recently expanded its communications business into 39 other African countries. In Nigeria alone, it has invested US$ 800 million to build new infrastructure for the country's mobile phones service operators (Alden & Davies 2006: 92). SACU has received investment into ICT, as well as in the mining and the automotive sector. The most lucrative investment for Chinese firms in the SACU region is in the exploration and processing of natural resources, especially in energy and mineral resources. In South Africa's Limpopo province Chinese investors have established *ASA Metals*, a ferrous processing plant, in partnership with the Limpopo Economic Development Enterprise of South Africa (Alden & Davies 2006: 87; ASA Metals 2008: Internet; Yang 2006: 29).

By the end of 2005 Chinese investments in South Africa amounted to US$ 253 million. This figure is only a third of the amount South African firms invested in China during the same period (Yang 2006: 29). This raises concerns for the region's industrialisation and socio-economic welfare. Are South African firms investing in China to profit from the country's consumer buying power, or are their new operations an attempt to reduce operational costs? The latter suggest that South African firms may be embracing China as their own manufacturing hub, without paying attention to the long-term implications of this strategic decision.

5.6.2 Wholesalers, Merchants and Chinese Restaurants

Since 1990 the SACU region has experienced unprecedented political, economic and social transformation, predominantly as a result of South Africa's democratisation. This period is marked by the lifting of all racial restrictions on movement, residence and business activity, which has opened the region to migrants and immigrant entrepreneurship (Peberdy & Rogerson 2000: 25). The only restriction in SACU's immigration law is the movement of labour. People seeking temporary residence (for studies or employment) in any other SACU country must obtain the required visa. As for people of Chinese origin, thousands of Chinese people emigrated and relocated their families across the SACU region during this period. Many of them operate small, micro and medium enterprises (SMMEs) in the retail or service sectors.

Technically, a SMME is usually managed by its owner and employs between five and fifty workers. A Chinese SMME tends to be a micro enterprise that is managed by its owner, but employs only between two and five family members or fellow Chinese immigrants. This category of Chinese business/investment in SACU can be easily dismissed as trivial due to its overlap with the informal sector. Accordingly, research on Chinese trade and investment tends to focus on their impact on the local economy. Early discourses on migration in Southern Africa suggest that immigrant entrepreneurs drain the region's economic and social resources (Peberdy and Rogerson 2000: 27). It is imprudent not to distinguish between voluntary migration and forced migration, of which the SACU region receives both. There are countless foreign professionals and entrepreneurs that make a positive contribution to the region's economy. However, SACU is also affected by thousands of refugees and illegal migrants. Trade unions thus have difficulty recognising the positive impact of migrants, or Chinese SMMEs for instance, on the region's businesses and development. Measuring the impact of Chinese SMMEs in SACU is also a challenge across some sectors, more than others.

Chinese restaurants and fast-food outlets in the region have also become more visible in major cities – e.g. *Bite Restaurant, Golden Dragon*, *Kung Fu Kitchen, Lien Wah, and Orient Fusion*. Chinese stores, gift shops and shopping centres have sprouted in and around the city centres of the SACU countries. Shopping centres, like *Dragon City* and *China City* in Johannesburg, supply local and Chinese merchants with TCF products, electronics and fast-moving consumer goods (FMCG) at wholesale prices. The quality of the Chinese imports has set a new pace to the FMCG industry in the region (Alden & Davies 2006: 93). Whereas previously the 'Made in China' stamp was associated with cheaply made and cheaply priced consumer goods, today it carries more weight amongst internationally acclaimed designers and brands whose products are increasingly manufactured in China. Ultimately the market penetration of Chinese goods and services in the SACU region indicates a growing economic and social affinity to all things Chinese, which may be cemented and thus further propagated by an FTA. The next section explores three possible futures to this effect.

5.7 Possible Futures – Raising Issues of Concern

There are different and often contradicting scenarios of the impact an FTA between SACU and China would have on the region. This dissertation only offers three. Economists, politicians and scholars have used various trade models to examine and scientifically calculate their theories. The global models use macro-economic frameworks to review trade between the two parties, while the sector models use micro-economic frameworks to review the prospective impact on industries and socio-economic welfare (Meyer, Punt, Reynolds & Sandrey 2008: 2). The three scenarios presented below are not exclusive of either one of these models, but rather present a combination thereof in order give as much of a comprehensive projection.

5.7.1 Market Access and Trade Diversion

By the nature of its preferential status, FTAs generally improve market access for exports. Once trade barriers are reduced or eliminated, the most visible result is increased trade between the trade partners. However, increased trade immediately after the implementation of FTA does not necessarily mean there has been more production from the exporting country. Although augmenting one's production is the ideal because it would provide increased earnings, however a hike in the quantity of trade may also be a result of trade diversion. This issue was thoroughly examined in Chapter 3, in relation to trade patterns observed once Mexico implemented NAFTA and South Africa implemented the TDCA. In NAFTA's case, it was concluded that no evidence of trade diversion had occurred in favour of the USA and Canada since the implementation of the FTA. However, the data in the case of the TDCA was inconclusive,[57] as there has only been a marginal increase in South Africa's exports to the EU (see Figure 3.4). However, for both of these developing countries, note that the FTAs strengthened their economic relations with their respective main trade partner. Yet, China is not SACU's main trade partner. Therefore, a potential SACU-China FTA may transform the ranking of SACU's main trade partners.

Using the Global Trade Analysis Project (GTAP)[58] there is a theory that suggests that SACU and China both stand to gain from an FTA, but at the expense of other international trading partners. Market access into the Chinese market may even have little effect on local production, despite an increase in SACU's Chinese imports and exports. This means that Chinese competition will simply displace SACU's existing trade relations, which at the moment are most likely to be those with the European Union (EU). Note that SACU's trade with China is still marginal compared to the region's trade with the EU and the USA. In 2006 China had a goal of doubling two-way trade with Africa to US$ 100 billion by 2010, yet by 2008 trade between both parties had already reached US$ 108 billion (DFID 2009: Internet). Their mounting trade

[57] The TDCA has not entirely liberalised the EU market - at least for the sectors that matter the most to SA exporters (refer to Chapter 3).

[58] The GTAP is a simulation of global impacts by a computable general equilibrium (CGE) model. It forecasts, amongst other features, the trade levels as well as import and export prices between different countries.

volumes are bound to have some inadvertent casualties. This theory of trade diversion suggests that SACU's existing trade with the EU will be replaced by increased trade with China (Meyer et al. 2008: 3; Sandrey & Jensen 2007: 12; Wang 2007: 6). Trade diversion is a common phenomenon in the international system, especially when preferential trade terms such as an FTA are set in motion. In SACU's case, it could be a great drawback for the BLNS countries. Although certain products may be more cost-effective in the global market, they may also be less competitive in SACU due to trade barriers - e.g. tariffs and quotas (Sandrey 2006a: 3). Back to the initial point, besides the impact of an FTA-induced trade diversion on the EU, what would its impact be on SACU in this scenario?

According to GTAP findings (Meyer et al. 2008: 3), by the year 2015 South Africa's GDP would have increased by 0.23 percent, generating an additional US$278 million compared to China's new gain of US$ 314 million. South Africa's exports would also have increased, but by a mere 1.1 percent or US$ 0.23 million. SACU would, however, continue to export similar volumes of agricultural products and commodities, but increase its imports of general machinery and manufactured goods. The imports from China would amount to an extra US$1.6 billion, 53 percent of which will be concentrated in the TCF sector. Since SACU is merely displacing its trade and gaining trivial economic profit (no cost of tariffs), it appears that the FTA in this scenario (i.e. trade diversion) benefits China more than its does SACU countries. SACU would simply, and most probably, only gain access to cheaper products made in China instead of those made in the EU.

African diplomacy, including SACU in this instance, suggests there is a general trend towards diversifying economic partners in an effort to change inherited colonial habits (Yang 2006: 32). One may already observe how the alterations in trade patters are affecting political dynamics at a global level. Media reports and publications suggest that many African countries, including the SACU countries, consider engaging with China as an alternative to the West – Western firms and the International Financial Institutions[59]. Unsuspectingly this form of behaviour in international political economy

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[59] The IFIs are the World Bank and the International Financial Corporation (IFC).

can be referred to as diversion. But how does trade diversion affect the socio-economy of SACU and the region's industrialisation?

Since the onset of its double-digit growth rate in the 1980s China, has experienced an unprecedented record of economic development. With a middle class expanding to well over 100 million people, there is an increasing demand for fruit, vegetables, dairy products, and meat. This is reflected in China's decision to grant South Africa (and SACU by default) formal access to its citrus market by reducing trade barriers (Naidu 2005: 473). Although the BLNS countries have marginal records of citrus production and exports, in 2005 South Africa exported ZAR 3.18 billion worth of citrus fruits – ranking the world's third largest exporter of citrus. However, the global citrus market is very competitive, and very little of South Africa's exports enter the Chinese market. According to the Citrus Growers Association of South Africa, its exports are levied an aggregate 12 percent tariff to enter the Chinese market (Mandigora 2006b: Internet). However, through Lesotho SACU could gain more competitive access into China for 440 products under its LDC status instead of through a SACU-China FTA. The average margin of preference for the LDC duty-free export products is 10.4 percent, meaning China's other trade partners will face a 10.4 percent tariff on the respective products (Minson 2008a: 3).

According to GTAP findings noted above, SACU's exports of agricultural products to China would certainly increase if the tariff was annulled, but this would most likely be a result of trade diversion. Therefore, since SACU's agricultural sector and commodities form the crux of its competitive (with the greatest absolute) advantage, this scenario of trade diversion indicates SACU has little to gain from a SACU-China FTA. Trade diversion refers to a change in export destination. Therefore, SACU would still be producing almost as much as it currently does. In this scenario the FTA thus satisfies the PRC's mounting demand for energy resources, commodities and reassurance of food security, but does not necessarily benefit SACU. Industrialisation in SACU would remain stagnant, producing the same volumes of goods and simply changing their target market. This does not suggest that SACU has reached its maximum production capacity, the GTAP findings simply insinuate that preferential trade with China will only affect the market for SACU exports and not the quantity of SACU's production.

5.7.2 Impact on SACU's Industrialisation

In the event of a free trade agreement with China, the region's industries and prospects for new industrialisation will be effectively challenged. Local manufacturing companies will face incredible competition from the competitively priced Chinese imports as well as investments. Recall that in Mexico's case NAFTA facilitated increased FDI, which in turn placed local companies in direct competition with newly established US businesses (Yunez-Naude 2002: 11). In a developed country, this would typically free up the skilled labour and channel it into other sectors of the economy. However, in a developing region like SACU, the immediate effect of high trade competitiveness is retrenchments, which would further exacerbate medium to long-term unemployment. For Mexico, it resulted in severe retrenchment and increased the country's unemployment rate when the workers could not be reintegrated into the economy. SACU's semi-skilled and unskilled labour force has marginal prospects of being reintegrated into the economy, especially without new growth in the country's manufacturing sector (Davies 2005: 159). With the bulk of SACU's manufacturing sector based in South Africa, the BLNS countries generally forfeit much of their labour force to South Africa in the form of labour migration. As examined in the previous chapter, labour migration forms one of the key characteristics of the socio-economic environment of SACU. Furthermore, the quality of the labour force is also a major issue in SACU, examined earlier in this chapter. The SACU region critically needs to enlarge its skilled and professional labour force. However, since this predicament cannot be resolved instantaneously, the region is inundated with unskilled and semi-skilled labour that needs to be incorporated into the economy.

Critics claim that the removal of all trade barriers from all Chinese imports is premature, especially considering socio-economic conditions in the SACU region. It would be counter-productive to SACU's regional industrialisation efforts and would only further exacerbate the levels of unemployment, thus increasing the spread of poverty. For instance, Chinese companies tendering for contracts in the SACU region tend to submit lower bids due to their cheaper labour costs and undervalued currency. In 2005 the steel producing company Ispat Iscor awarded a Chinese consortium (CITIC-ARCE) to a build a coke oven battery and gas plant in Newcastle (in the Kwazulu-Natal province of South Africa). The consortium allegedly drafted hundreds of Chinese workers on its payroll, on the basis of South Africa's 'lack of local expertise'. This raised much controversy considering Murray and Roberts and Aveng Grinaker Ltd, which are two of SA's major construction companies, had also bid for the contract (Naidu 2005: 474). Apart from the highly contentious Black Economic Empowerment (BEE) regulations, the private sector in SA (and SACU) functions under relatively free market capitalist principles. At what point then must the state impose restrictions and barriers to create an incubating environment for technology transfer and skills development?

Chinese exports to SACU are already constrained by quotas (Sandrey 2006b: 8). Allegations and/or incidences of dumping and unfair competition, amongst other trade practices, will strain relations between SACU and China. Unless resolved bilaterally, either party may resort to lodging a formal complaint and record a dispute at the World Trade Organisation (WTO), especially over unilateral interpretations of the other's protectionist trade policy (Naidu 206: 459). Incidentally, SACU's textile, clothing and footwear (TCF) industry is an exemplary scenario of the negative impact of a possible FTA between SACU and China.

According to South Africa's DTI the MOU concerning China's voluntary restrictions on its TCF exports to SACU was only valid until the end of 2008. Note that TCF imports from China already face a 40 percent tariff to enter into SACU (Sandrey 2006b: 2). The voluntary act placed import limitations on 100 products from 31 product categories. However, this effort was estimated to restrict only one third of Chinese TCF imports. Dr Martyn Davies, Executive Director of the Centre for Chinese Studies, based at the University of Stellenbosch, argues that the agreement is not feasible. A political memorandum of understanding (MOU) cannot play the role of a legally binding document that shall be implemented into law. It is thus impractical to assume that the Chinese government could command thousands of privately owned TCF companies to withhold their intended exports (Africa Research Bulletin 2006: 17001). In the meantime, South African trade unions claim that the country has already forfeited 800 firms and nearly 65 000 jobs as a direct result of imported Chinese TCF products (Alden & Davies 2006: 93).

5.7.3 Perpetuating the North-South Model of Trade

The statistics and analysis of trade examined above mark certain trends and patterns that SACU (and African countries as a whole) is currently experiencing with Western countries. The implications of this on the region could be detrimental to sustainable development. It will provide limited opportunity for entrepreneurial labour-intensive industrialisation (White & Alves 2006: 61). The SACU region has an abundant supply of cheap, unskilled and semi-skilled workers that need to be channelled into the formal economy.

According to White & Alves (2006: 56) China should not be simplistically interpreted as an alternative to the West – former colonial powers and/or *neo*-imperialists. China's relations with SACU should rather be viewed as one with mutual reciprocity, which should promote sustainable development in the region while satisfying China's economic needs and demand for access to commodities. Market liberalisation should therefore reflect the needs of SACU and China without becoming a liability. Therefore, one must recognise that removing trade barriers and opening the market to China under the auspices of an FTA may confine SACU's avenue for new industrialisation and economic development (White & Alves 2006: 61). Structuralist theories claim there is an unequal distribution of wealth and power within the international capitalist system, which concur with the dominant powers (countries and institutions) by endorsing and perpetuating what has been coined as a North versus South trade system (Balaam & Veseth 1996: 70). Accordingly, because of the current trade profile between SACU and China, an FTA would actually perpetuate the existing North-South model of trade. It is a system that holds countries captive, which by restricting their prospects it enables a perverse form of dependency.

Recall points raised in *The Modern World System*, written by Immanuel Wallerstein, on the world's fundamental socio-economic differences (refer to Chapter 1). Wallerstein (1974: 63) proposed the categorisation of states into three units and describes them as follows:

- The core: the states conduct highly-skilled industrial activity and modes of production;
- The semi-periphery: intermediary between the core and the periphery; and

- The periphery: states that export primary commodities.

In Mexico's case, its maquiladora sector confirms the country's semi-peripheral status. In South Africa's case, the TDCA has merely facilitated the export of primary commodities, since SA's manufactured exports are not as competitive in the EU market. Using Wallerstein's categorisation to interpret the information provided on SACU and China, one may deduce that SACU also forms part of the periphery. It exports mostly primary commodities and agricultural products, especially in its relations with China. As the emerging global manufacturing hub, China would form part of the semi-periphery; the core would then consist of countries from Western Europe and North America. What does this mean for SACU, especially in the event of an FTA with China?

Solidifying economic diplomacy and integrating one's market with strategic trade partners are important to countries. Although the intention is to improve earnings, FTAs may also cause a loss of income. As a result of the TDCA, South Africa's customs revenue generated from EU imports declined by ZAR1 808 million in 2006, which is of grave concern to Lesotho and Swaziland.[60] Some analysts, like Sandrey (2006a: 10) for instance, claim that there has also been a significant amount of trade diversion from SACU's other trading partners due to the EU's preferential treatment. Nonetheless, the EU's subsidising of its farmers continues to jeopardise the cost competitiveness of South Africa's exports. In sharp contract, NAFTA's effect in this regard has been positive. Since Mexico has the cheapest labour force in NAFTA, it has experienced increasing rates of FDI that have prompted economic diversification in the industrial and service sectors of the economy (Sanchez-Reaza & Rodriguez-Pose 2002: 76).

It would therefore seem that China's appetite for commodities confines SACU's role to one which primarily exports raw materials and agricultural products (Naidu 2005: 459). Considering China's highly competitive industrial sector, the GTAP model suggests that a SACU-China FTA would offer limited new industrial development in SACU. In fact, the infiltration of Chinese goods, demonstrated by the TCF sector, would flood the market and may cause local industries to collapse. SACU negotiators need to evaluate

[60] Lesotho and Swaziland depend on SACU customs for revenue, supplying nearly half of their countries' total earnings (Sandrey 2006a: 4).

whether there is an opportunity for the region to export more value-added goods to China as opposed to being condemned to exporting more commodities and raw materials, in which case the SACU countries would certainly be disadvantaged (Alves 2006: 6; Naidu 2005: 475). The negotiators would also need to enclose sufficient timeframes for the reduction of SACU's trade barriers in order to afford sector reform in SACU and provide regional industries with sufficient time to adjust.

5.8 Conclusion

The WTO's Doha Round of trade negotiations shows little promise of resolving the various issues raised by its members. Although most countries in the international system are anxious to see principles of multilateralism working in the interest of all, in the international political economy the playing field is already uneven. SACU is a regional organisation whose members are indefinitely trapped by the construct of their colonial and apartheid history. The region's industrial hub is centred in South Africa, whose economy is based mostly on primary commodities and agricultural produce. SACU faces socio-economic challenges that affect its current and prospective levels of productivity. Even so, the region has much to offer the world and so China has taken a key interest in strengthening its economic relations with SACU by means of an FTA.

China has found a new role in the international community, as a global manufacturing hub and an aspiring financier. In this new role, China has begun to set the standard global prices for input products (raw materials), for low-cost manufactured goods. Despite the controversy surrounding China's interests in SACU and the rest of the continent, the prospects for trade and investment are evident. As such, the objective of this chapter was to examine the implications of a possible SACU-China FTA on the region's business and industrialisation.

Three scenarios were presented. First, the implementation of an FTA between SACU and China would automatically increase the volume of trade between the two parties. However, a clear distinction must be made between trade creation and trade diversion. The forecast increase in trade between SACU and China will most likely be a direct result of trade diversion, which will be at the expense of the EU. SACU exports would have greater market access to the Chinese market, at lower costs and therefore be more competitive. The gains for SACU are minimal in this scenario, as trade diversion simply changes the target market for export products and makes an insignificant amount of change to SACU's level of local production, industrialisation and socio-economic welfare.

Second, SACU's imports from China, on the other hand, hold grave implications for the region's welfare. Demonstrated by the effect of Chinese TCF imports on local industries, further market liberalisation in SACU would be detrimental to existing businesses and limit the region's prospects of industrialisation. This introduces the third scenario of a 'North-South' model of trade. Without direct value added, SACU's position appears rather peripheral. It would continue to export raw materials and agricultural products to China, in return for finished goods and manufactured products that are sold directly to the end consumer. This trade profile does not appear to encourage development through industrialisation, but rather limits SACU's development efforts to mere trade. Since official diplomatic propositions have already been made to initiate FTA negotiations, this study has revealed that due consideration will need to be taken by both parties to ensure that a SACU-China FTA does not disregard sustainable development interests.

CHAPTER 6

SUMMARY AND CONCLUSION

6.1 Introduction

The level of trade between SACU and China has escalated over recent years, especially since China joined the World Trade Organisation in 2001 (Davies 2005: 165). Once South Africa recognised China's market economy status, the SACU region experienced rapid growth of imports from the Chinese market. SACU's exports to China, although limited to primary commodities, have also increased substantially in the new millennium. Accordingly, SACU and China's leaders formalised expressions of interest in 2004 to negotiate a FTA, which would encourage bilateral cooperation and enhance their terms of trade. The prospect of a SACU-China FTA has thus raised much debate over the implications it would have on the region's businesses and its development agenda.

Market liberalisation has been a major priority in the international capitalist system since the GATT was established in 1948 (later succeeded by the WTO). However, the Doha Round, dubbed 'the development round', has demonstrated shifting priorities in the global trade forum (Collier 2006: 1430). The focal point of inertia in the Doha Round has been its inability to strike a balance between productive market liberalisation and destructive market liberalisation. The challenge lies in bridging inter-sectoral trade liberalisation between countries that are at different stages of development. Developing countries that open their markets to imports run the risk of devastating local businesses and/or forfeiting industrialisation. Accordingly, the SACU region may face similar outcomes if/when a FTA with China is signed.

The first part of this chapter outlines the contributions made by this study, as well as suggestions for future research opportunities in this field. It is followed by a summary of the theories and empirical literature, data and findings, and the policy implications and recommendations that this study bears for SACU trade negotiators.

6.2 Contribution of this study

The majority of studies on SACU's bilateral relations investigate only certain regions or specific sectors of industry. Moreover, the majority of studies on China's emerging economy and its contribution to world trade generally investigate its impact on the global market system and how African countries are fuelling China's growth trajectory. Only a few South African based research institutes have begun to publish reports that shed some light on the current state of regional integration in SACU and its relations with China – namely the Centre for Chinese Studies (CCS), the South African Institute for International Affairs (SAIIA) and the Trade Law Centre for Southern Africa (TRALAC).

The first contribution made by this study is an empirical estimation of the impact the FTA may have on SACU's regional integration and industrialisation. The bulk of SACU's manufacturing sector, which is currently based in South Africa, is extractive and based on primary commodities (see Figure 5.2). Yet, economic sustainability can only be guaranteed through industrial diversification, especially of consumer goods production (Salvatore 1987: 14). SACU's predicament is worsened by the lack of a regional industrialisation policy that will address these needs, as well as guide its selection of strategic partnerships with the rest of the world. Therefore, if SACU fails to formulate a consolidated regional policy framework of industrialisation, its bilateral engagement with China will also fail to meet the individual needs of the SACU countries. This may cause tension in the region, especially once SACU begins to experience an influx of Chinese imports under the FTA conditions. Essentially, the FTA may devastate the competitiveness of local businesses - infant and established – as well as inhibit the development of new industries.

The second contribution made is the estimation of the quantitative outcome of a SACU-China FTA. The FTA will certainly prompt increased trade between the regions, but it will have a minimal effect on SACU's total GDP. Instead, the only major change will be in the ranking of the region's main trade partners. The FTA will encourage trade diversion, due to the preferential terms of trade between parties against the rest of the world. In SACU's case, the forecast increase of trade will occur at the expense of the region's current main trade partner – the EU. This means that the production levels in

SACU will not improve a great deal, as only its exports will be redirected to China. The same principle applies to SACU's imports as well. The FTA will stimulate a shift in SACU's sourcing of imports, especially considering the cost competitiveness of Chinese products.

The third contribution made in this study is the critical observation of what a SACU-China FTA implies in the global economic system vis-à-vis China's emerging economy. Apart from the political rhetoric of symbolic diplomacy, a FTA may provide increased market access, investment opportunities and resource security. However, one factor that has been overlooked is the portfolio of trade products. A SACU-China FTA will not encourage trade diversification, but will rather increase the scale of the current trade products. SACU will continue to export mostly primary commodities to China, in exchange for manufactured goods. This profile mirrors a North-South model of trade, which is not conducive to SACU's industrialisation (Balaam & Veseth 1996: 70). As such, a SACU-China FTA would be unproductive, as it would endorse and perpetuate SACU's peripheral role against China in the global capitalist structure.

6.3 Future research opportunities in this field of study

Due to the broad field of study on SACU's bilateral relations, the opportunities for future work with respect to this study are endless. Possible future research which could be indentified is:

(i) *The formulation of a SACU regional policy framework of industrialisation.* Lack of a consolidated policy framework makes it difficult for SACU to establish foreign economic relations with third parties.

(ii) *A gap analysis to identify key strategic partners for SACU.* The liberalisation of trade relations with third parties shall be determined by a matrix of the region's needs and the most optimal sources in the rest of the world.

(iii) *Diluting the Common Market Pool: the implications for Lesotho and Swaziland.* Trade liberalisation would inevitably result in the loss of a revenue stream that is valued by SACU's smaller economies.

(iv) *The prospect of a monetary and economic union in SACU.* Regional organisations that operated as one consolidated economy increase their competitiveness in the international market.

(v) *The feasibility of expanding SACU's membership.* Considering the overlapping in member in regional integration agreements in Southern Africa, what are the prospects of aligning SACU to SADC?

6.4 Summary of findings

A number of theories, hypotheses and schools of thought endeavour to explain international trade and recommend model principles. However, none of them successfully explain international trade on their own. Theories of international trade are classified in a number of ways, and in this dissertation a distinction is drawn between the two main contending theories and the main critical theory (refer to Chapter 2). The evolution of the Westphalian state system has caused an evolution in international trade, but one that is often overlooked. As a result, the history of trade, as well as its role in development and in industrialisation, often contradicts the discipline that has been recorded in international relations. Therefore, this dissertation has made use of various theories and meta-theories to examine trade in the context of SACU and China.

The theories, hypotheses and schools of thought on international trade explored in this dissertation include: the production structure, the knowledge structure, mercantilism and economic nationalism, protectionism, liberalism, bilateralism, multilateralism, free market capitalism, structuralism, Marxism, imperialism, and dependency theory. The main ideas contained in the aforementioned assisted in the selection of appropriate explanatory variables, relationships and trends identified in the empirical research. Furthermore, they assisted in indentifying similarities used to analyse the politics of SACU-China trade, as well as to estimate and project the prospective implications of a SACU-China FTA on the region's businesses and industrialisation.

The purpose of Chapter 3 was to provide evidence of the effect of FTAs between countries that are at differing stages of development. Attention was paid to two specific FTAs – NAFTA and the EU-SA TDCA (as a part of SEFTA). Although the two case studies presented distinct findings on the impact the FTAs have on their respective member countries, both case studies offered complimentary variables that were extrapolated to study the possible implications for the SACU region, if it were to sign a FTA with China.

For Mexico, NAFTA enabled the country to strengthen its economic relations with its most dominant trade partner. Similarly, the TDCA solidified South Africa's relations with the EU – its main trade partner. Due to regional dynamics, NAFTA also boosted Mexico's economic profile on the global capitalist system. This resulted in increased foreign direct investment and increased exports. However, South Africa has not experienced the same outcome from its agreement with the EU. Due to certain remaining tariff and non-tariff trade barriers imposed by the EU, South Africa has not been able to benefit as much from the TDCA. This feature highlights the importance of negotiating the most optimal deal of market liberalisation for one's priority sectors, even when the trade-off appears to be daunting.

Although consumers tend to be the biggest beneficiaries of market liberalisation, the irony is that consumers also form part of the labour force. Market liberalisation brings a variety of choices and marks down the cost of products, due to competition. However, the competition may also devastate local businesses and cause unprecedented retrenchments. For a developing country, this only further exacerbates poverty by raising the unemployment level. This point was evident in Mexico shortly after it joined NAFTA (see Chapter 3). Furthermore, a developing country may struggle to develop a competitive local industrial capacity once its market is liberalised.

In Chapter 4 the geopolitics of SACU uncovered a history of internal discrepancies which continue to obscure the region's foreign relations with third parties. Their differing stages of development are a variable for their conflicting interests in China. Furthermore, a position on the prospect of a FTA is futile as long as Swaziland maintains diplomatic relations with Taiwan.

Chapter 5 revealed that the optimal reason for developing stronger economic ties with strategic trade partners would be to further growth and improve one's socio-economic welfare. However, bridging the gap between the two can be a challenge, as mere economic growth does not necessarily result in an improvement in the conditions of living of ordinary people. GTAP findings reveal that if a SACU-China FTA were implemented, by the year 2015 it would increase South Africa's GDP by a mere 0.23 percent (Meyer et al. 2008: 3). Furthermore, Sandrey & Jensen (2007:12) claim that any increase in trade that may occur as a result of a SACU-China FTA, will be the result of trade diversion.

6.5 Policy implications

SACU countries face many socio-economic challenges that they each must effectively address to enable them to synchronise their national strategic plans. The organisation is riddled with a colonial legacy that encouraged an uneven distribution of resources in the region. Therefore, although SACU may appear to be an impressive model of regional integration on the continent, it faces several operational challenges and endures a range of inconsistencies.

The results show that the region has little to gain from a SACU-China FTA, especially in comparison to the risks it would bear. Chinese manufactured goods are more competitive than those produced in SACU. The only optimal comparative advantage for SACU against China lies in its export of primary commodities and raw materials. The premature implementation of SACU-China FTA will have negative implications for the region. Primarily, it will restrict SACU policy choices if/when a regional industrialisation policy requires an incubating environment of state protection for the sustainable development of a globally competitive industrial sector. Following the above, a number of key policy recommendations are posited in the next sub-section.

6.6 Policy recommendations

The policy recommendations provided here aim to ensure that SACU's trade relations with China are not based on or determined by dependence, but rather by a partnership that is indeed mutually beneficial and also reflective of SACU's development agenda:

- Policy changes and improvements are needed in SACU's Council of Ministers and Secretariat to ensure the **effective implementation of decisions**. One of SACU's main goals is to oversee the harmonisation of the national policies and strategic papers of the member states. However, the signing of the TDCA and EPAs, which are external PTAs, demonstrates a lack of regional consolidation.

- The SACU Secretariat needs to formulate a **policy framework for regional industrialisation** that will stimulate sustainable development and economic stability. This is critical to bridging the economic gap between South Africa and the BLNS countries. The BLNS economies require skills development, infrastructure development, improved social services, and effective legal, financial and regulatory frameworks. Within SACU there exist significant socio-economic disparities that will be exacerbated by a SACU-China FTA. A clear industrialisation programme is imperative to identifying gaps that become key variables during FTA negotiations.

- A **Common Negotiating Mechanism** (CNM) is needed to channel SACU trade negotiations with third parties. The CNM will homogenise the foreign policies of all the SACU countries, complimenting the existing single customs territory status.

- A uniform **SACU policy on China** is required to synchronise the agendas that each of the SACU countries have with China. Swaziland will first need to cease all ties with Taiwan, in favour of the PRC's 'One China' policy that the remaining SACU countries adhere to.

- Certain sectors of the region's economy, even more specific to certain countries, may appreciate selective levels of **protectionism** to incubate their operations. This factor is acknowledged in the SACU agreement, regarding intra-SACU market dynamics. However, considering the experience of the region's textile industry and the influx of Chinese TCF products in the retail sector, it is advised that SACU legislates and regulates the necessary precautionary measures to protect its industries across all sectors.

- Regarding a prospective SACU-China FTA, SACU should opt for a long-term framework of market liberalisation. Only selected/strategic sectors should be liberalised gradually, in phases that will give the local market sufficient time to adjust to external reflexes. SACU and China must develop a **sectoral cooperation** agreement before launching FTA negotiations. All the SACU countries are presently engaging China at a bilateral level, which is not conducive to cementing regional integration.

- **Production sharing** is a component of globalisation that has transformed conventional mass production, allowing several distinct sub-processes or operations of production to be performed in different parts of the world (NG & Yeats 2004: 170). In order to break the current cycle of the SACU-China division of labour, SACU will need to negotiate specific terms of economic engagement with China. Regarding exports, SACU will need to negotiate boosting the value of its products through processing and/or packaging of products. This will stimulate industrial activity in the region, while simultaneously increasing export earnings.

In January 1998, the United Nations Economic Commission on Africa held a conference in Addis Ababa. James Wolfensohn, then President of the World Bank (1998: Internet), made the following statement:

> "*Africa needs to set itself up to attract private investment and that means a clean regulatory environment, it means a judicial system that works, it means property rights, corporate law, predictability in taxes and, in relations to governments, it means capacity building, health care, and the infra-structure to go along with it. And it means that corruption must be stamped out. Without these, private investors simply will not invest.*"

Ten years have transpired but the statement remains valid, especially for the weaker economies in SACU.

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